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5 April 2013

Electricity System Operator Incentives: consultation on a scheme for 2013

EDF Energy is one of the UK's largest energy companies with activities throughout the energy chain. Our interests include nuclear, coal and gas-fired electricity generation, renewables, and energy supply to end users. We have over five million electricity and gas customer accounts in the UK, including residential and business users.

We welcome Ofgem's proposal to introduce a target based incentive scheme for the System Operator (SO) from April 2013 to March 2015. A target-based incentive scheme is preferable to a cost disallowance approach as it is more transparent and more likely to incentivise the SO to investigate innovative methods to minimise the costs of balancing the system and should reduce costs to consumers.

We summarise below our key messages:

- We welcome National Grid Electricity Transmission's (NGET) efforts to explain its models used to derive a BSIS target to stakeholders. Although we now have a better understanding of its models and methodology, as a third party we still rely on Ofgem to confirm whether the models are suitably robust for use under the interim scheme.

- Model development will continue to be a challenge especially with the emerging developments in the market which are likely to affect the role of the SO going forward. Continued engagement with stakeholders is necessary during the interim scheme to avoid any surprises when the enduring scheme is introduced.

- Separately, Ofgem is proposing to launch a new project on Future Trading Arrangements. Should Ofgem decide to launch such a project, 'SO incentives' are a work area which it may also wish to consider given potential interactions.

- In terms of measures to help reduce volatility of BSUoS charges, one alternative is to introduce a mechanism that locks in the forecast for a set period, (e.g. one year), with reconciliation in the following year. An over and under recovery mechanism which adjusts costs in future years could stabilise BSUoS costs for the purposes of customer charging.

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Our detailed responses are set out in the attachment to this letter. Should you wish to discuss any of the issues raised in our response or have any queries, please contact Mark Cox on 01452 658415, or myself.

I confirm that this letter and its attachment may be published on Ofgem's website.

Yours sincerely,

Angela Piearce
Corporate Policy and Regulation Director

Attachment

Electricity System Operator Incentives: consultation on a scheme for 2013

EDF Energy's response to your questions

CHAPTER: One

Q1: Do you agree with our proposal to put a balancing services incentive scheme in place for 2013-15?

Yes. A target based incentive scheme, broadly similar to the existing scheme, is preferable to a cost disallowance approach or having no scheme at all.

Q2: How much confidence do you have in the ability of the models to set a robust target given recent developments to the models and methodology?

The Plexos model demonstrated by NGET in February 2013 provided additional confidence. It was encouraging to note that replacing forecasted inputs with ex-post data returned a high degree of accuracy. However, ultimately, we are relying on Ofgem to assess the results from the fully calibrated models to determine whether the models are suitably robust for use under the 2013-2015 scheme.

CHAPTER: Two

Q1: What are your views on making balancing mechanism 'pseudo' prices an ex post input in the energy models? What additional considerations may exist?

NGET has some ability to influence the prices it receives in the Balancing Mechanism (BM) but the level of influence it has is probably limited in the short term. Therefore, it would seem sensible to make the BM 'pseudo prices' (ex ante volume weighted average prices) as an ex post input. By making the input ex-post, it should remove a potential source of target setting error.

Q2: What are views on the appropriate length of time for input of transmission limits? What value do you place on having forecasts ahead of time which are as accurate as possible?

We concur with Ofgem's suggestion of more frequent updates. Outages and maintenance schedules should be published as frequently as the SO is able to do so. EU REMIT/Data Transparency regulations are likely to require more reporting of these, and should provide material for input to SO incentives and modelling.

A three monthly update would be better than a yearly update as it gives suppliers the ability to reflect any changes to costs in a timely fashion. Customers tend to secure supply contracts less than a year in advance. Using a yearly approach, the information when signing a customer could be unnecessarily out of date.

At the Operational Forum in February 2013, NGET informed stakeholders that BSUoS costs for November 2012 had out-turned higher than forecast due to a known outage. The SO had not updated its forecast as it was not required to under the 2011-2013 Incentive Scheme. We believe NGET should be obliged to provide more frequent updates.

Q3: What are your views on the requirement for, and appropriate level of, a discount factor to be applied to the constraints model?

Although we understand that the 41% discount factor is used under the current scheme, there is not enough information or evidence provided in the consultation to support or oppose the proposed discount factor. A challenging but fair target should be set based on the actual costs that can be achieved by contracting ahead of the BM, especially in a changing generation mix environment.

CHAPTER: Three

Q1: Do you agree with our proposals for the key parameters of a BSIS?

Yes, in general.

We agree that model development will continue to be a challenge especially with the emerging developments in the market which are likely to affect the role of the SO going forward. An interim two year scheme is sensible under the circumstances.

However, continued engagement with stakeholders is necessary during the interim scheme to avoid any surprises when the enduring scheme is introduced.

Separately, Ofgem is proposing to launch a new project on Future Trading Arrangements. Should Ofgem decide to launch such a project, 'SO incentives' are a work area which it may also wish to consider given potential interactions.

Q2: What are your views on the one year update provisions and the requirement for income adjusting event provisions?

We fully support a 'two by one year' scheme which allows inputs to be updated. However, a more pro-active approach would be welcomed and the timings of when information will be provided for the second year of the scheme need to be confirmed.

We would encourage the SO to go further and inform the industry of any potential changes as soon as possible. For instance, an input change noted within the first month of year one would only be applied when setting the following year some 10-11 months later.

We also agree that if the 'two by one year' scheme is taken forward, there is a potential case for the removal of income adjusting event (IAE) provisions. However, further assessment is necessary.

Q3: Do you have any views on the types of inputs that may be suitable for adjustment as part of the mid-scheme provisions?

As identified in the consultation, we have concerns that the IAE provisions can result in ex-post changes to BSUoS charges. We therefore agree that it would be helpful if the materiality threshold is increased from £2m to £4m and the scope for IAEs are limited.

We would also welcome the timely publication of information that could lead to an IAE as soon as possible to reflect this in forecasts.

Q4: What do you consider to be the merits/disadvantages of applying the scheme retrospectively to the 1 April 2013? Do you consider this to be the best option for the 'interim period'?

Although we do not support, as a rule, application of retrospective charges, we believe that the relatively short delay in the scheme will not have a substantial adverse effect.

CHAPTER: Four

Q1: What are your views on the additional incentives that we are proposing to include alongside a BSIS?

We generally support additional incentives that allows for innovative ways to reduce the financial burden of BSUoS costs to consumers. We would like to ensure that the administration and overall benefit of such incentives are proportional to any reward given.

Q2: In particular, what are your views on the merits of including a discretionary reward scheme alongside a BSIS? And what are your views on our proposals for the parameters of a scheme?

We support the discretionary reward scheme that promotes benefits to consumers. We would want assurance that any investment made will, over the course of the current and future schemes, remain beneficial.

Q3: What are your views on the additional incentives that we are proposing not to include alongside a BSIS?

In terms of Transmission Losses Reputational Incentive, we agree with Ofgem's proposal to remove the current financial incentive and replace it with a reputational incentive that complements the RIIO-T1 incentive.

Q4: Do you agree with our proposal not to include a BSUoS forecasting incentive? What measures could help to reduce volatility of BSUoS charging going forwards?

Yes. We appreciate, with additional ex-post inputs moving into the proposed 2013-2015 scheme, a financial incentive on BSUoS forecasting is challenging and therefore accept that any forecasts produced by the SO would be erroneous.

In terms of measures to help reduce volatility of BSUoS charging (for the purposes of customer charging), the application of an under/over recovery adjustment of costs in future years is one such option. Clearly, more certainty through reconciliation will be helpful. We cannot identify other methods, without overhauling the entire scheme that would allow for a reduction in volatility.

EDF Energy
April 2013