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Proposed Income Adjusting Events submitted by National Grid Electricity Transmission in relation to the 2011-13 Electricity System Operator Incentive Scheme

Dear James,

This response is provided on behalf of RWE npower, RWE Generation SE, RWE Supply and Trading GmbH and the UK subsidiary of RWE Innogy GmbH, RWE npower renewables.

We are writing in regards to your recent letter seeking views on NGET's (National Grid Electricity Transmission) notice to yourselves of several Income Adjusting Events (IAEs) that occurred during the System Operator Incentive Scheme 2011-13. These IAEs, if agreed, could impose extra cost on Suppliers, Consumers and Generators of up to £51.1m introducing further volatility to the already extremely variable BSUoS cost base. This will fall heaviest on consumers who have pass-through contracts in place with their Suppliers and will therefore be exposed to the restatement of these costs. Consumers on non-pass through contracts will not receive this additional cost and therefore pass-through consumers will be discriminated against.

For the avoidance of doubt we do not agree that imposing retrospective costs on consumers for losses agreed to in a mutually scoped incentive scheme is an acceptable premise. Furthermore any costs incurred by NGET as a result of the events identified are the natural consequence of commercial risk/reward framework and should therefore be upheld. If all events are retrospectively adjusted there would be no risk/reward to speak of and therefore very little point in having an incentive scheme.

Our overriding concern with this process is the principle of certainty that a well regulated incentive scheme should give to industry and consumers and the acceptance of risk in return for potential reward that NGET should adopt. NGET agreed to a cap and collar of £50m at the start of the scheme designed to limit any reward but also to reduce the amount of risk that they would face. This was obviously seen as an acceptable level of risk at the time and therefore the fact that events occurred to incur this level of cost should not be seen as a reason to adjust NGET's income. If this level of risk was unacceptable to NGET then the incentive scheme should not have been agreed to.

In the case of Transmission Losses we believe the causes of this could have been anticipated before the incentive scheme was agreed. There has been widespread understanding that additional northern based generation (including renewables) would

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displace generators elsewhere on the network. NGET should not have agreed to a transmission losses incentive within their scheme if they were unwilling to accept a loss caused by the changing events of the market. We note that within the 2013 scheme the financial incentive has been removed, illustrating that NGET are no longer willing to bear this risk. In fact, in other areas of the NGET business NGET calculations indicate very little change in the losses for additional generation located in remote regions.

We believe that NGET should be able to forecast these differences quite accurately and be able to control all the varied factors that lead to higher losses. It is indeed possible that some of the increases in transmission losses are associated with losses in equipment that NGET have added to the network to control flows and increase power transfers.

We also note that, due to the favourable market conditions for opted out LCPD coal plant, these Transmission loss issues should have been mitigated to a certain extent due to longer sustained running of southern based generators using their hours when market spreads supported this.

Within the IAE application for the Moyle interconnector outage NGET state on paragraph 5 of page 3:

"Given that National Grid has no control over the available capacity of the Moyle Interconnector, nor any provision for managing this within the incentive target, we therefore consider this to constitute an Income Adjusting Event (IAE) with respect to the 2011-13 Balancing Services Incentive Scheme (BSIS)."

As mentioned above, if NGET had no control over a factor that would influence their ability to manage risk that they had exposed themselves to they should not have entered into this incentive scheme in the first place. Both this, and the Smeaton situation, illustrate that as this system constraint risk is sensitive to unforeseeable events it is inappropriate to create an incentive scheme that relies on predictable performance for acceptable returns.

NGET go on to say in paragraph 36 on page 9:

"In addition National Grid had run tenders for constraint management services within the affected area and procured services to cap generation and agree hours of intertrip arming. These contracts were either in place before the fault occurred or, in the case of those agreed after the fault, would have been signed regardless of the status of the Moyle interconnector."

This illustrates that NGET were fully aware that there was a constraint risk within the region and had indeed taken action to mitigate it. The fact that the scale of the issue became larger than their expectation should not deflect from the fact that they knew of this risk and were willing to take action to mitigate costs. This should, therefore, be seen as further acknowledgement that NGET were aware of the risks of the scheme and entered into it in spite of that knowledge. We believe that there is no justification for any special treatment for costs incurred by NGET especially for an issue known in advance of the scheme.

In both of these cases we would have expected either NGET or the regulator to understand that there were unacceptable and unavoidable risks associated with these schemes and not accept them. We are extremely concerned that this was not the case and that potential further exposure of consumers to unexpected costs has resulted. We are pleased that some of the more unrealistic risks have been removed from the current SO incentive scheme and expect that this will be the case in future.

NGET must have also considered that there was sufficient opportunity for them to achieve value up to the cap which is after all the principle of the incentive scheme. We note that there is no recognition of where income may have been gained through "unknown" events in NGET's favour and we do not think it likely that all events across the period of the scheme would have acted to the detriment of NGET. A fuller appraisal of where costs were less than expected and therefore had a positive impact on their end of scheme results is necessary for this to be considered in the round.

Although we do not agree with the principle of reopening the incentive scheme for 2011-2013 we have some further comments on the mechanism by which these should be invoiced to industry if accepted.

For the further establishment of predictability and transparency in all network charges, as helpfully developed in your conclusions last October, ("Decision in relation to measures to mitigate network charging volatility arising from the price control settlement") the solid principles of giving the market notice around volatile costs and allowing Network Operators to recover these costs in future periods sets an important precedent that this set of events should also follow. We believe it is far more appropriate for NGET to adjust their costs for future periods allowing consumers to appropriately budget for this cost transfer and the market to effectively price in any future cost movements than to levy retrospective charges. This gives greater certainty to investors and consumers alike that unanticipated events will be managed in a way that allows the greatest transparency. We suggest that this could occur in the following incentive scheme period (ie 2015-2017).

Finally we would urge that NGET, in both its TO and SO business, endeavour to create a process that is more integrated in assessing benefits of investment but also risks in terms of incentives that may not be fully controllable by either entity individually.

If you have any questions or require further information regarding our response then please do not hesitate to contact me.

Yours sincerely

Jonathan Wisdom

Network Forecasting Manager
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(sent by email so unsigned)