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Dear Ian,

National Grid Electricity Transmission System Operator Incentives from 1 April 2010

Thank you for providing SSE with the opportunity to comment on the above consultation. We have detailed our responses to the consultation questions below.

1. Do you consider that the final proposals for the SO incentive scheme to apply to NGET's external SO costs represent a fair balance of risk and reward.

In general, we believe that Ofgem's final proposals provide a fair balance of risk and reward.

We agree with Ofgem's view that the form of the scheme should remain as it is, a bundled scheme for one year, but should be altered to have symmetrical sharing factors for 2010/11.

Despite the fact that we support an extended scheme (beyond one charging year) as a longer-term goal in principal, we agree with Ofgem's decision that it is too late to introduce such a scheme for 2010/11.

We agree with Ofgem's proposed target and deadband levels, recognising that NGET's forecast is within the deadband so that if they meet their estimate they will not lose money.

We note that the new incentive scheme will take effect after two months of the financial year have passed. We understand the reasons for delay. Nevertheless, we do not believe that the scheme should be applied retrospectively: by definition applying the mechanism retrospectively cannot influence NGET's behaviour.

Q2. Do you consider that the proposed licence modifications appropriately reflect the final proposals as described in this chapter?

By and large, we believe the proposed licence modifications accurately reflect Ofgem's final proposals. However, we believe that licence condition 4(b) should be altered to reflect the fact that, for the 2010/11 scheme year, any relevant material change in the volume of the specified key variables and the associated costs of such a material change can no longer be agreed prior to the commencement of the 2010/11 scheme year i.e. the 1st April 2010 has now passed. The licence condition should be altered to reflect the fact that it is now only possible for such a change to be applied retrospectively.

We also like to note that we welcome Ofgem's proposal of a new special licence condition which will require NGET to cooperate with the Authority in undertaking a review of the methodology for developing its forecast and multi year schemes. We believe the timescales laid out in Special Condition AA51: licence condition 1, 2 and 3, may be challenging considering that, as the statutory consultation process has still to be conducted, the earliest licence conditions may come into force is mid May 2010. However, we believe such timescales are vital to allow for a due consultation process with industry.



Q3. Please provide your views on our proposed way forward regarding future years and the development of multi year schemes.

NGET Forecasting

We share Ofgem's concerns in regards to NGET's forecasting methodologies. We believe that the dramatic swing from **£962m** to **£601m** seen in NGET 2010/11 forecast is unacceptable. Therefore, we welcome Ofgem's immediate commencement of a review of NGET's current modelling methodology.

However, as discussed in detail in our letter to Ofgem on 8th January 2010, we believe that the key issue that must be dealt with in order to resolve NGET's forecasting issues, is the perverse incentive NGET is given by the current scheme to forecast high cost levels. We believe the introduction of an Information Quality Incentive (IQI) and an Economic Purchasing Obligation (EPO) would be the most effective and efficient method to mitigate this problem.

The principle of IQI is that the licensee has a choice over the risk/reward regime based on the variance between the licensee's forecast and the view of independent consultants. Through this mechanism the inherent incentive to "forecast high" is mitigated by diminishing rewards as a consequence. The effectiveness of the IQI in driving behavioural change has been demonstrated in both electricity distribution and gas distribution. This principle might, we believe, be quite simply translated into the SO incentive in relation to forecast constraint costs (or more widely).

The (now revoked) EPO on Public Electricity Supplier (PES) licensees was a mechanism that allowed Ofgem to investigate the level of costs and the efficiency of such costs incurred by the licensee and, subject to the outcome of that investigation, make an adjustment to the level of allowed costs. The intent of the EPO was to translate into the licence the general duty of licensees' to be economic and efficient specifically in the context of purchasing energy from the market. If a licensee could not provide evidence that all of its costs had been incurred efficiently, then it faced an investigation and potential disallowance of those costs.

The principle of the EPO should, in our view, be applied to external SO costs providing both an incentive on the SO to act efficiently at all times and a mechanism for Ofgem to monitor, and where appropriate investigate, the efficiency of external system operation costs. This could be achieved by a new licence condition on National Grid, modelled on the former PES EPO, and incorporated as part of the SO incentive scheme.

Additional comments

We still have concerns with the timing of the setting of the scheme parameters in relation to NGET's contracting for services. There can be reluctance on NGET's part to contract for services ahead of agreement of the scheme.

We also would welcome transparency of the adjusters agreed between NGET and Ofgem.

We hope you find this information useful. If you would like to discuss any of the point raised in more detail, please do not hesitate to contact me.

Yours sincerely,

Claire Rattey
Regulation Analyst