

# **National Grid Gas and Electricity System Operator Incentives Response to Initial Proposals Consultation**

This response is submitted on behalf of ScottishPower Energy Management Ltd, ScottishPower Generation Ltd and ScottishPower Renewable Energy Ltd.

## **Electricity System Operator Incentives**

### **Question 1: Do you agree with the assumptions used to forecast the various elements that make up the underlying balancing costs?**

The core forecast assumptions of no change to the BSC or CUSC baselines from 1 October 2007 and no change to Cashout or Transmission Access are required to provide a stable platform from which to forecast balancing services costs.

### **Question 2: In particular, do you have any comments on views on National Grid's forecast assumptions for cost drivers:**

**i. The behaviour of Net Imbalance Volume during 2008/09 can be expected to be broadly in line with that seen during the current year, 2007/08?**

We believe that it remains difficult to forecast NIV as it is not yet clear which factors have influenced market participant's behaviour in 2007/08 to date and whether those factors will persist in influencing behaviour into 2008/09.

**ii. That the forward price is the most appropriate figure to represent the likely outturn wholesale price during 2008/09?**

We agree that the forward price is the most appropriate figure to represent the likely outturn wholesale price during 2008/09.

**iii. That wholesale power price either directly drives or acts as an appropriate proxy to index certain balancing costs?**

Wholesale price will bear a strong correlation to certain balancing costs such as the costs of Fast Reserve, Reactive and constraint costs. However there may be a less strong correlation with other services such as Black Start. Any indexation of costs in the SO incentive scheme should only be applied where this strong correlation exists.

### **Question 3: Do you agree with the assumptions used to forecast Cheviot and Scottish constraint costs, and the costs associated with the forecast rise in wind output in 2008/09?**

The use of a probabilistic model to forecast Cheviot and Scottish internal constraint costs is a reasonable basis for determining the range of possible outcomes. We cannot comment on the appropriateness of the assumption of a 30 week outage period as this is within the control of the Transmission Owners. However, we would expect close monitoring from the System Operator to ensure that the outage period is reasonable and not excessive.

**Question 4: Do you have any comments on our initial analysis of the likely impact of the introduction of the Large Combustion Plant Directive, in particular on the likely operation of opted-out plant?**

We would agree with National Grid's initial analysis that the LCPD will result in BM Units from opted-out plant being operated on a stack basis with simultaneous synchronisation. It is not yet clear how the running regime will be affected, but the assumption that the 20,000 running hours will be utilised on an even basis over the 8 years may be overly simplistic.

**Question 5: Do you have any comments on the forecast range of incentivised balancing costs and BSUoS costs for 2008/09?**

The forecast range of BSUoS costs for 2008/09 has been derived mechanistically from the aggregate of the assumed balancing service costs. The forecast BSUoS charge of £1.15/MWh represents an increase of 11.6% on the forecast outturn for 2007/08 and will ultimately have to be passed through to consumers at the same time as increased wholesale electricity costs.

**Question 6: Do you agree with the main areas for efficiency identified by National Grid?**

The main areas identified for efficiency by National Grid are in optimisation of the dispatch optimisation algorithm introduced in July 2007 and achievement of cost reductions in frequency response procurement. We would like National Grid to be more explicit in identifying any further efficiency measures and their associated benefits.

**Question 7: Do you agree with the range of proposed scheme options? Are there alternative scheme structures that should be considered for 2008/09?**

The 6 scheme options provide a range of levels of risk and reward and include the option of indexing up to two of the variables which National Grid state are outwith their control. We have not identified any alternative structures which would better achieve the objectives.

**Question 8: Do you support the use of indices for the 2008/09 incentive scheme:**

**i. Do you agree with the proposed level of scheme target indexation for wholesale power price?**

The option of indexing targets to wholesale prices removes this uncertainty from the System Operator targets. However, the analysis carried out on the correlation between daily Incentivised Balancing Costs and day ahead wholesale price was not conclusive and the proposed index of £2m / £1/MWh does not appear to be robustly supported by the data. In addition, we are concerned that National Grid's actions in the market may affect market prices whilst they remain protected from the impact of consequent price changes through indexation.

**ii. Do you prefer wholesale power price index option (a) or (b)?**

Should indexation be introduced, option (a) would reflect market movements within the year more accurately and is preferable to option (b) which merely moves the timing of the setting of the target closer to the start of the financial year.

**iii. Do you agree with the proposed level of scheme target indexation for Cheviot outage weeks?**

We are concerned that the introduction of an index for Cheviot outage weeks reduces the incentive on the System Operator to bring maximum pressure to bear on the Transmission Owners to minimise the outage period but recognise the uncertainties which affect such a major programme. We would therefore be prepared to support the use of Cheviot outage indexation.

**Question 9: Which is your preferred scheme?**

Our initial preference is for Scheme 2 which is based around the central forecast of £530m (including a 30 week Cheviot outage) but incentivises the System Operator to achieve deep costs savings with a generous upside sharing factor.

**Question 10: Do you agree that longer term development of systems that will reduce the cost and carbon impact of operating the system should be supported? Which manner of funding do you consider to be the most appropriate?**

We agree that systems should be developed to reduce the cost and carbon impact of operating the system in line with the Government's environmental objectives. Development could be funded through the SO incentive scheme by the introduction of an allowance based on the market price of carbon and the carbon savings achieved.

**Question 11: Did you find the level of information within this consultation, and associated documentation and workshop, on our balancing and BSUoS costs forecasts for the current year and 2008/09 informative? What additional information should National Grid provide to explain better the costs and cost drivers?**

The level of information provided in the Initial Consultation and its Appendices has been comprehensive and has been well supported through public and bilateral meetings. It would be useful to have a further update to 2007/08 outturn figures and the likely impact on 2008/09 targets prior to the conclusion of the consultation period.

**Question 12: Do you have any further comments on the analysis and information provided?**

We have no further comments on the information and analysis provided. We have no further comments on any other aspect of the consultation in relation to the electricity SO incentives.

## **Gas System Operator Incentives**

### **Question 13: Do you agree with the approaches used in forecasting the various elements that make up NTS shrinkage?**

We believe that there is scope for refinement of the shrinkage volume calculation, including a greater alignment with current costs.

### **Question 14: Do you support the continued linking of shrinkage target volumes with flows at the St. Fergus entry point, and do you support the move to an increased number of bands?**

Yes, for now we support the continued linking with flows at the St Fergus terminal. We also believe that an increased number of bands should improve the validity of the incentive.

### **Question 15: Do you agree that the SO should not be incentivised on CV shrinkage that is outside of its control?**

All procurement for shrinkage purposes should be subject to a commercial incentive. However, National Grid should not be subject to a volume incentive on elements outwith its control. We would welcome any review of the appropriateness of the existing rules.

### **Question 16: Do you have an objection to the proposed interim GCRP and ECRP methodologies for 2008/09?**

We have no fundamental objections to the proposed methodologies.

### **Question 17: Do you support the proposal to establish the proposed enduring GCRP and ECRP methodology arrangements into National Grid's GT Licence for an extended period?**

Yes, we support the proposal to establish the proposed enduring methodologies for 2008/09.

### **Question 18: Do you agree that the incentive cost target should be constructed in the way proposed in this consultation?**

We agree that there are benefits from longer term incentives but we do not believe that significantly more aggressive incentives are necessarily appropriate.

### **Question 19: Which of the scheme options do you believe is the most appropriate way to incentivise the costs of utilising OM?**

Our preference would be for Option B, with a utilisation cost collar of £0.5m.

### **Question 20: Do you agree that a one year scheme is appropriate pending a potentially more fundamental review of the residual balancing incentive going forward?**

Yes. Given that it would be only a one-year scheme we would appreciate the review of the incentive to be conducted as soon as possible.

### **Question 21: Which of the scheme options do you believe provides the most appropriate incentive arrangements for the residual balancing activity for 2008/09?**

We would prefer scheme B, with the removal of the linepack incentive, which we believe has had little impact on National Grid's behaviour.

**Question 22: Do you agree that the current Demand Forecasting incentive should roll forward to 2008/09 pending a more fundamental review of the residual balancing activity and incentives?**

Yes, we agree that the current demand forecasting incentive should roll forward.

**Question 23: Do you think it is appropriate to widen the data items that are subject to incentivisation to include the additional data items outlined in the proposal?**

We agree that additional data items could be included, but are not convinced these should be stand-alone incentives rather than elements of an additional performance measure.

**Question 24: Do you agree with the proposed scheme design in terms of timeliness and availability elements, and the provisions for planned upgrades/ monthly measurement intervals?**

Yes, we believe these measures are appropriate.

**Question 25: Which of the proposed performance improvements and associated incentive schemes do you believe is most appropriate?**

We are not convinced any of the additional incentive schemes are required, but we would seek to ensure that National Grid performs against its existing targets pending a more fundamental review.

**Question 26: Are there any other points that you would like to raise in relation to the setting of the gas SO incentives from April 2008?**

We have no further points to raise on the setting of the incentives from April 2008.