

Consultation Questions

1	<p>Do you agree with the areas identified as the main cost drivers for 2008/09? Are there any other drivers not explicitly identified?</p> <p>Yes. SSE agree with the areas identified as the main cost drivers for 2008/09.</p>
2	<p>Do you agree with the high level assumptions outlined:</p> <ul style="list-style-type: none">- utilisation of forward power prices and the 60% - 160% range?- market length central and ranges?- generation availability and utilisation of OC2 data? <p>Whilst stressing that SSE are not in a position to verify all of the assumptions adopted by National Grid as we do not have access to the same amount of component data that support the build up of these assumptions, SSE believe that they seem broadly reasonable.</p> <p>However, as recognised by National Grid in the consultation, wholesale power price assumptions look high given current market prices and it is essential that revised views of wholesale power prices are fed into the forecast model prior to final submission to the Authority for approval.</p>
3	<p>Do you agree with the assumptions (described in detail in the appendix) used to forecast the various elements that make up underlying balancing costs?</p> <p>Again SSE would highlight that we are not in a position to verify all of the assumptions stated by National Grid for the same reason as highlighted in Q2. Notwithstanding this, broadly SSE agree that the majority of the assumptions utilised to estimate underlying balancing costs seem reasonable. We would however make the following observations.</p> <p>Whilst recognising the commercial sensitivity around providing a more robust STOR forecast, and accepting that costs will need to be updated to reflect revised tender prices in January (as recognised in the consultation), it is not clear to us why forecast costs are increasing by £20m. We look forward to National Grid's updated view on STOR costs and commentary on cost drivers influencing them when available. We would urge National Grid to issue more up-to-date information on forecast STOR costs at the earliest possible opportunity.</p> <p>Similarly, we also believe that a number of cost forecasts influenced by wholesale power price (e.g. reactive costs and costs influenced by the underlying cost of generation) are overstated, given our view that the baseline power price assumption appears to be high.</p>

We would expect forecast costs for these areas to reduce when recalculating the numbers prior to submission to the authority for approval. Again, we would urge National Grid to issue more up to date BSUoS forecast costs as soon as possible.

SSE continue to recognise the ongoing impact of transmission reinforcement work and introduction of new wind generation upon constraint costs. However the extent of the forecast increase in these costs (a 60% increase on current year forecast outturn) is very significant. We recognise that a large amount of this increase is due to a specific, transient construction related constraint associated with a new connection in England & Wales.

Whilst SSE do not have access to the relevant information to determine whether the forecast figures are reasonable (we rely on the Authority to provide this scrutiny), we would urge National Grid to continue to develop appropriate and innovative tools to manage these risks and costs.

For example, we believe that greater use could be made of competitive tendering for intertrip services. Competitive tendering ensures that all potential service providers are aware of the service requirements and have the opportunity to compete. This should help to ensure that the service is secured by National Grid in the most economic and efficient price. As an alternative to the use of intertrip services a more effective Constraint Management Tender service could be developed. All potential service providers would have the opportunity to participate and compete.

Equally, it would be helpful to have increased transparency on the costs associated with managing constraints, i.e. the level of costs incurred in managing the constraint compared to the costs incurred in procuring replacement energy, as well as an estimate of costs attributable to LCPD related constraints. This would help identify whether more effective tools can be developed to minimise costs.

Additionally, we would encourage National Grid to be more transparent and open in its requirements particularly in relation to constraints and give greater consideration to the placement of forward contracts. We believe that this would give greater volume flexibility and is likely to deliver a more efficient price. Similarly, we believe that the industry would benefit from a longer-term view of requirements, i.e. beyond the next incentive year.

At a more detailed level, we would make the following observations.

National Grid forecast the level of wind generation coming on in Scotland to go from 1450MW to 2383MW in Winter 2009. SSE are

not convinced that 800-900MW of new generation will connect during 2009/10 and are concerned that there is a potential for constraint costs to be overstated, at some £148m. Additionally, it is not clear whether or how this increased generation is phased over the year, and is therefore not clear at what point the costs might be incurred. SSE seek assurance that the peak and phased increase in wind generation is robust, as this is such a significant cost driver for 2009/10. SSE trust that the Authority will provide the appropriate oversight of detailed models to ensure that this is the case.

We support the assumption that no additional constraint cost allowance should be made for potential outage overruns. However, given that much of the forecast is based on extrapolation of time weighted historic data, it is not clear whether the 2009/10 forecast has an element of overrun cost allocated via the inclusion of 2008/09 overrun costs in the historic data set. We seek assurance that National Grid has made an appropriate adjustment to its 2009/10 constraint cost forecast to remove any potential impact of 2008/9 outage overrun costs.

An assumption has been made that constraint costs will be higher because a key intertrip scheme will be unavailable for 4 weeks. We seek assurance that National Grid have explored all other alternative technical solutions to manage this constraint and minimise cost, e.g. use of other intertrip schemes.

It is not clear whether any improvement in Cheviot constraint costs are being anticipated for Q1 2010 (subject to final delivery of reinforcement works on time). We seek assurance that an allowance has been made within the forecast for a benefit associated with the removal of constraints on managing post fault levels, as a consequence of reinforcement works on the second double circuit across Cheviot.

It is not clear whether the reactive power volume forecast has made allowance for changes and enhancements to the network during the year, including SVCs, as opposed to an extrapolation of historical volumes. We seek assurance that the potential benefits of network improvements have been recognised in the forecast and an appropriate volume adjustment applied.

There seems to be an inconsistency between the forecast view of Transmission Losses, which are predicted to rise, and the forecast view of constraints, which are also predicted to rise, particularly in the North of the country. If Northern generation cannot run because of North-South constraints, and the principle driver of Losses is generation location, then an increase in forecast Losses is counterintuitive. Further explanation is required to detail how Losses can rise in this scenario in order to justify the forecast.

Finally, very little evidence is presented to support the assumption

	<p>that demand side service providers will help to reduce operating reserve and response costs. We trust that the assumption has been made with specific service providers in mind.</p>
4	<p>Do you agree with the areas identified as the main cost drivers for 2009/10? Please explain your rationale. Are there any other drivers not explicitly identified?</p> <p>In particular, do you agree with the assumptions used to forecast margin (reserve, STOR and BM start up) and constraint costs?</p> <p>Broadly, we agree that the areas identified will be the main cost drivers for 2009/10, subject to comments made in previous questions with regards to margin and constraints costs.</p> <p>Notwithstanding this, it is not clear whether National Grid have taken any account of the impact of energy efficiency measures on demand curtailment; and the impact of economic slowdown upon demand destruction and price contraction (particularly associated with businesses failing and the potential effects of a deflationary recession). It is our understanding that forecasts are predominantly derived from extrapolation of historical data. We believe that greater consideration should be given to whether forecasts should be adjusted where changes in trends are known or anticipated or where there are known future events.</p> <p>We believe that National Grid should be formulating a view on these probable impacts and factoring this view into the forecast.</p>
5	<p>Do you have any comments on the assumptions used in determining the increase in costs associated with the revised operation of the England / France interconnector known as Use it or lose it?</p> <p>The consultation suggests that there is scope for interpretation in the application of the EU Directive. However SSE do not believe that National Grid's interpretation is correct. The comment in the assumptions about the potential need to run oil units in the South regardless of costs is counterintuitive to the intentions of the Directive, and on that basis we do not believe that National Grid's interpretation is correct. SSE trusts that the regulatory authorities will provide the necessary direction and scrutiny to ensure the correct interpretation and operation of the interconnector.</p> <p>Notwithstanding this point on interpretation, the remaining assumptions seem to be reasonable. It is assumed however that in deriving its figure of £21m that National Grid has considered any potential benefit that may accrue from new generation coming on-line during 2009 in the South and South West of England.</p>
6	<p>Do you believe that we should include some provision for a volume of additional generation connecting as a result of the interim connect and manage arrangements? If not, how do you believe we should manage the risk of additional generation connecting?</p>

	<p>Yes, however, this should be conditional upon National Grid releasing additional capacity to the network.</p>
7	<p>Do you agree with the implementation of a new adjustment as described as new NIA? If not, please outline your rationale?</p> <p>Recent trends support National Grid’s view that the system has tended to be closer to balance on average, thus reducing free headroom and adding to the need to incur costs to maintain statutory margin obligations. It is appropriate that National Grid remain appropriately incentivised to manage these costs optimally.</p> <p>Assuming that this trend continues, we agree that new NIA provides an appropriate method of adjusting the incentive to neutralise the impact of market length and power price volatility upon balancing costs associated with energy imbalance, response and reserve creation.</p> <p>We note that this results in a very significant forecast Net Energy adjustment for the overall incentive (almost equivalent to the total forecast margin costs and approximately 40% of the overall forecast summary).</p>
8	<p>Do you agree with the implementation of a new reactive power index? If not, please outline your rationale? Are there any other indices that we should consider?</p> <p>Yes. SSE agree with the implementation of a new reactive power index. We also support National Grid’s decision to limit indexation to reactive power costs only – we do not believe that use of other indices are appropriate at this time.</p> <p>SSE do not believe that National Grid should be (fully) exposed to changes in wholesale power price given the clear correlation between wholesale power price and the costs of procuring reactive power and the lack of influence that the SO can exert over wholesale prices. As long as an appropriate indexation methodology is applied, then it is a sensible way to adjust the incentive to limit National Grid’s exposure.</p>
9	<p>Do you have any comments on the forecast range of incentivised balancing costs and BSUoS costs for 2009/10? Specifically do you believe that the range is too wide or narrow or do you believe it represents the full range of costs?</p> <p>The forecast range is very wide and volatile, which retains a high level of uncertainty and exposure to outturn BSUoS costs to industry. Our principle concerns are to minimise the actual costs incurred in balancing the system, hence we continue to support incentivised arrangements, but equally we require more upfront certainty on the potential outturn BSUoS costs. The range of</p>

	<p>uncertainty presented does not assist with upfront certainty, and we would continue to encourage National Grid to look at how alternative incentive arrangements might be developed in the longer-term that provides better certainty year-on-year or over a 3-to-5 year period. We reiterate our previous comments that National Grid explore all possible measures and seek more innovative contracting strategies and tools, and be more open and transparent in its requirements in order to keep costs to a minimum and help to mitigate the range and uncertainty on forecast costs.</p>
10	<p>Do you have any comments on option 1? In particular:</p> <ul style="list-style-type: none"> - sharing profile - benefits / drawbacks of such a scheme - do you support implementation of such a scheme in April 2009 <p>Given the wide range of uncertainty on high, medium and low cost forecasts, we believe that Option 1 should be adopted for April 2009 as it provides a reasonable risk/reward profile and better incentivises National Grid across the range of potential cost outcomes than Option 3. We prefer Option 1 as a means of maintaining an incentive upon National Grid across the range of possible outcomes rather than move to a scheme that sets multiple targets within-year.</p>

11	<p>Should we consider a change to the incentive period of to ensure that an incentive remains on National Grid over the year? Would you support the implementation of such an incentive?</p> <p>On balance, we do not believe that a change in the incentive period from annual to within year is necessary. Indeed, we can foresee even greater forecast volatility associated with a scheme divided within year and much greater administration costs for the entire industry.</p> <p>Rather, SSE continue to support the development of a longer-term incentive scheme that will allow National Grid to develop more innovative tools and solutions over time to assist in optimising system balancing costs.</p> <p>We are also mindful that National Grid retain a licence obligation to balance the system in an economic and efficient manner regardless of whether incentive floors have been exceeded or not. We trust National Grid to comply with their obligations.</p>
12	<p>What could such an incentive scheme look like?</p> <ul style="list-style-type: none"> - incentive period (e.g. monthly, quarterly) - caps and collars - sharing factors <p>As we do not support a change to a within-year incentive period, we have no view as to what the scheme may look like.</p>
13	<p>Do you agree with the implementation of reactive power indexation?</p> <p>Option 4 is not SSE's preferred option, but, were a bundled scheme to be implemented, we agree with the implementation of reactive power indexation for the reasons described in Q8 above.</p>
14	<p>Do you agree with the unbundling of reactive power? Should the bundled scheme caps and collars be changed from £20m?</p> <p>SSE support the unbundling of reactive power as this will allow the adoption of a multi-year scheme for this element of the incentive scheme. SSE support a move towards a multi-year incentive scheme for the reasons outlined in Q18.</p> <p>SSE believe that a change in the caps and collars associated with the remainder of the bundled scheme would be appropriate were a scheme that retained caps and collars to be adopted.</p>
15	<p>Do you agree with the unbundling of transmission losses? Please give your rationale.</p> <p>SSE support the unbundling of transmission losses as this will allow the adoption of a multi-year scheme for this element of the</p>

	incentive scheme. SSE support a move towards a multi-year incentive scheme for the reasons outlined in Q19.
16	<p>The transmission losses reference price is currently calculated on an annual basis. Do you believe there are any benefits in changing this to a more frequently calculated transmission losses reference price, such as daily? Please give your rationale.</p> <p>SSE are opened minded about the possibility of calculating the transmission reference price over a different interval, but can find no compelling evidence in the consultation to support why National Grid thinks that this might be appropriate. We believe that the annual reference price should remain in place until appropriate analysis is provided that makes the case for change.</p>
17	<p>Are there any other components that you believe should be unbundled?</p> <p>We do not believe that any other areas of the incentive scheme are suitable to be unbundled at this point in time.</p>
18	<p>Do you agree with multi-year reactive power scheme? Please give your rationale.</p> <p>Yes. SSE have previously advocated our preference for a longer-term SO incentive scheme to be developed, as we believe that this gives a longer time horizon over which National Grid can make more efficient and innovative investment decisions. We therefore welcome measures that move toward longer-term arrangements.</p>
19	<p>Do you agree with multi-year transmission losses scheme? Please give your rationale.</p> <p>Yes. SSE have previously advocated our preference for a longer-term SO incentive scheme to be developed, as we believe that this gives a longer time horizon over which National Grid can make more efficient and innovative investment decisions. We therefore welcome measures that move toward longer-term arrangements.</p>
20	<p>Are there any other components that you believe should have a multi-year scheme?</p> <p>SSE would prefer the entire scheme to be a multi-year scheme, however we recognise that this may be difficult to achieve currently. We would continue to encourage National Grid to investigate how such an incentive scheme could be delivered in the fullness of time.</p>
21	<p>Which is (are) your preferred incentive scheme(s)? Please provide reasons and your views on caps, collars and sharing factors.</p> <p>Our preferred incentive scheme package is :-</p>

	<p>Option 1 – bundled incentive for all costs excluding reactive power and transmission losses for the reasons outlined in Q10 above +</p> <p>Option 7 – multi-year unbundled reactive power incentive for the reasons outlined in Q18 above +</p> <p>Option 8 – multi-year unbundled transmission losses incentive for the reasons outlined in Q19 above.</p>
22	<p>Do you have any comments on the forecast range of BSUoS costs for 2009/10?</p> <p>Please see Q9 above.</p>
23	<p>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.</p> <ul style="list-style-type: none"> - What additional information should National Grid provide to explain better the costs and cost drivers? <p>Yes, SSE believe that National Grid have made a real effort to inform the industry of its incentive proposals and forecasts.</p> <p>Notwithstanding this, there are some areas where perhaps improved transparency would have been helpful, in particular greater transparency of constraint costs to differentiate between primary costs associated with management of the constraint and secondary costs associated with replacing the energy.</p>
24	<p>Do you have any further comments on the analysis and information provided within the appendices to this consultation or in the further documentation available on our website?</p> <p>No.</p>
25	<p>Do you have any further comments on any aspect of this consultation in relation to the Electricity SO?</p> <p>Not at this time.</p>