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Date : 24 Aug 2009

Dear John,

National Grid Gas (NTS) System Operators Incentives for 1 April 2010

Thank you for providing Scottish and Southern Energy plc (SSE) with the opportunity to comment on the above Proposal.

We thank NG NTS for providing a comprehensive consultation document which allows for a thorough understanding of the incentive targets, the collars for risk/reward sharing and historical performance against the incentives.

SSE has provided where possible, the following answers to the specific questions posed in the consultation.

Question 2.1 Would you support bundling some or all of the shallow SO incentives? If so please explain which schemes should be bundled, what an appropriate performance measure would be and what benefits this would deliver?

SSE believe that the current level of un-bundling is appropriate. The existing 7 separate SO incentive areas have quite different performance measures, only 2 of which are cost minimisation related. Bundling any of these incentives together would be difficult to achieve in a meaningful measure and may lose transparency. The 2 cost related incentives; Shrinkage and Operating Margins have incurred a level of expenditure of £150 m and £18 m respectively and attempts to bundle these together will likely distort incentives due to the considerable difference in magnitude. Furthermore having a range of unbundled incentives allows schemes to be set with a range of objectives, targets and sharing factors. SSE believe the flexibility offered through these parameters allows individual schemes to be set to either reflect the size of the activity, the value of the activity to the market, the level of control NG has over

a certain outcome or to focus NG's resources towards a particular area of industry concern.

Question 2.2 Would you propose unbundling any of the existing SO incentives schemes? If so please explain the benefits that you believe would be achieved from this?

See comments to 2.1 & 3.1.

Question 3.1 Given the review of the residual balancing scheme carried out last year, do you support our view that another review of the incentive structure is not required this year?

SSE believes that the 2 components of the Residual Balancing incentive, the price performance measure & linepack measure are of potentially critical importance in influencing market price and trading sentiment. The 2 measures are directly related to one another and need to remain bundled together under the Residual Balancing incentive. The historical incentive payments of £1.5 m/year are sizeable however, against the potential impact on the wholesale market price the incentive appears to be appropriate.

Having reviewed the charts in the consultation we agree with NG that there are no apparent patterns at this time and the incentive introduced last year should not be amended at this time. This will allow an adequate monitoring and reporting period to determine how appropriate the incentive is.

Question 3.2 Do you have any views/evidence that further refinement of the residual balancing scheme parameters is required?

The linepack measure target of 2.8 mcm is commercially driven and not a physical requirement. It is possible that as a result NG undertake more balancing actions than actually required. However, cumulative day on day changes to linepack are limited by the above tight target which correctly incentivises within day action and ensures cost reflectivity. Before considering another linepack measure of say 10 mcm, we would require NG to provide additional data by repeating the charts contained in this consultation. This would then provide the industry with more information and enable a view to be taken on the cost benefit of a different measure.

Question 3.3 Are there any barriers to implementing a residual balancing scheme for more than one year?

SSE are generally supportive of multi year incentives. However, only once we are convinced that an appropriate incentive has been created. This has not yet been demonstrated in the case of Residual Balancing. When more years of data have been reported we will be better informed to comment.

Question 4.1 If National Grid was able to improve its demand forecasts, how would this impact on your business?

Improvements to demand forecasting will deliver value to the market through better information which in turn leads to better decisions. There is potential for substantial savings to be made by increasing the accuracy of demand forecasting as this will reduce the amount of trading required to balance positions.

Question 4.2 What value (or relative value) do you place on each of the demand forecasts?

The value of the demand forecasts is driven by the level of confidence in them and the time until physical delivery. Having more time before physical delivery creates more options for a shipper to achieve a balanced position at least cost. Hence if the confidence/accuracy of the D-7 forecast could be as good as on the day forecasts this would provide the most value. In practice the D-1 13:00 forecast has a reasonable level of accuracy that Users can have confidence in and provides a day to trade and change gas flows through the network. The challenge for NG NTS is to produce forecasts 7 days ahead of physical delivery that are as accurate as day ahead forecasts.

Question 4.3 Which of the forecast times do you believe should be incentivised?

The D-1 13:00 forecast should continue to be incentivised. In addition if the forecasts from D-7 to D-1 were improved this could potentially reduce the industry trading costs. Incentives to encourage NG to improve demand forecasts in the range D-7 to D-1 could be encouraged starting with monitoring and reporting of the level of accuracy.

Question 4.4 Should consideration be given to the introduction of an additional incentive around any particular element of the forecast?

SSE believes the Non Daily Metered (NDM) component of the forecast is of particular value, as each shipper has to make separate DM and NDM nominations. We believe an additional incentive designed to improve the NDM component of the forecast should be introduced.

Question 4.5 Should the structure of the Demand Forecasting incentive be reviewed?

The current incentive structure is based around the annual average level of forecast error. This structure implies that the value of an accurate demand forecast is equal for all days in the year (i.e. there is no increased value on winter or higher demand days) and that the focus of NG NTS activities is on reducing the average level of forecasting error rather than trying to specifically address the occurrence of an individual day with a large forecast error.

SSE believe that the current incentive structure should be modified to:

1. have 4 separate average level of forecasting error periods, Winter, Autumn, Spring & Summer to reflect the different market values.
2. have a separate incentive to avoid large peak single day errors in the Winter i.e. no more than 8 % absolute forecast error.

3. reduce the current average forecast error target from 3.2 % to 2.6 %. Historical evidence has shown that NG NTS can achieve this level of forecast accuracy. The recent rise in error is largely down to the worst demand destruction on record & hopefully not repeatable.

Question 5.1 What value do users put on the data items that are published under this incentive?

The incentive covers specific gas system data published on the National Grid website. NG NTS is incentivised to keep three key screens (Prevailing View, Data Item Explorer and Report Explorer) available with a target of 99.3% availability, and to publish 90.5% of the hourly updates for 4 reports (Predicted Closing Line Pack, National Forecast Flow, National Physical Flow, and Forecast NTS Throughput). This information is interesting and useful but not in the same category of importance as demand forecasting and we are surprised that in 2006 more incentive revenue was earned from this than for Residual Balancing. The new incentive revenue collared at £0.1 m is still too high for a routine part of core business for a regulated monopoly. We would expect over time as NG demonstrates its ability to maintain high levels of service against this incentive that the incentive payment is reduced to zero but that the penalties for failure are maintained.

Question 5.2 Are the current levels of website availability and timeliness of data publication appropriate?

See response to 5.1

Question 5.3 Does the incentive value of \pm £100,000 accurately reflect the value to users of having this data available and published in a timely manner?

See response to 5.1

Question 5.4 Are there any barriers to implementing an incentive scheme for longer than one year?

None that we can foresee.

Question 5.5 What information, if any, do users believe should be incentivised beyond the existing defined dataset?

NG NTS is a monopoly provider who earn a regulated revenue to run a safe gas network. We should avoid implementing unnecessary incentives for NG NTS providing functions and services that are part of the core business for which they are already rewarded.

Question 6.1 Does National Grid's summary (in section 6.2) accurately capture the issues with the existing maintenance planning process?

NG NTS have accurately captured our concerns of maintenance issues in this consultation document.

Question 6.2 Why would a change to the existing maintenance processes be of value to you?

Our particular concern is associated with changes being made to the originally agreed maintenance date by giving 30 days notice. When NG NTS subsequently change the maintenance date it is not always possible to reschedule the powerstation maintenance date and as a result the power station suffers 2 maintenance outages; one for NG work & one for specific plant related work. Power station maintenance is often undertaken by third party specialist contractors who need to be booked months in advance. A months notice of change is inadequate to reschedule and align to a single maintenance period. The lost revenue suffered by a power station when it has no gas connection and is unable to generate is dependent on the spark spread but can be multiples of £100,000/day.

Question 6.3 What behaviour change by National Grid would be required to deliver this value to you?

For NG NTS to keep the original agreed maintenance dates unchanged, unless both parties agree to a change.

Question 6.4 Do you believe an incentive on maintenance planning is required? If so what would the objective of incentive?

Yes, any incentive should encourage NG NTS to keep the original agreed maintenance dates unchanged, unless both parties agree to a change.

Question 6.5 Do you have any suggestions for a suitable incentive scheme?

Given the significant lost revenues that are incurred by power stations when they are unable to generate. The first step should be to incentivise or prevent the change of originally agreed maintenance plans unless agreed to by mutual consent. Any maintenance incentive would need to reimburse the losses incurred by power station operators. NGG would be incentivised on a share of these costs. The costs could be calculated using a standard market rate of on specific costs based on open book disclosure. Given that only 5 requests were made by NG in the period up to April 2009 to change original maintenance plans the subsequent costs would not be excessive.

Question 6.6 Could improvements be made to the existing communication process or UNC maintenances provisions?

The UNC could be altered such that no changes are to be made to the originally agreed maintenance dates unless both parties agree to the change.

Question 6.7 Are there any specific data items that National Grid should start recording that would help facilitate the debate on a maintenance incentive?

It would be useful if NG would publish on a quarterly basis:

1. The number of planned and actual maintenance days over a 3 year rolling period.
2. The data shown in the table below.

	Pre April 2009	Post April 2009	Total
Number of date changes requested by National Grid	5	1	6
Number of date changes requested by Users	23	4	27
Number of Users requests accommodated by National Grid	15	4	19
Number of Users requests not accommodated by National Grid	8 ¹²	0	8

Question 7.1 Have the key areas where further information on incentives is required been correctly captured?

Appendix 1 provides a comprehensive summary of the incentives; how they operate, the collars on risk return and the historic incentive performance. It will be useful to have this updated and made available in the future on NG's website.

Question 7.2 Are further refinements required to the summary of the incentive schemes (contained in Appendix 1) prior to its publication?

For proposed incentives under development it will be helpful to have historical data made available so that the impact of the incentive in terms of targets, collars and sharing factors can be understood.

Question 7.3 Would publication of the proposed graphs showing how performance to date of incentive schemes relates to end of year incentive payments be helpful?

Charts providing monthly information in terms of the performance to date and an indication of the potential range of year end incentive payments will be useful. However, we are aware of the potential limitations for trends not continuing or spurious monthly data. But we believe a level of reporting is preferable to no reporting. This type of reporting could be adopted for all of the schemes identified as having an annual target(s). For schemes with fixed caps or collars these could be added to the appropriate charts.

Question 7.4 Is there other information that could be used to better indicate likely end of year incentive payments?

Not at this time.

Question 7.5 Would publishing a standing item on the link between incentive revenues and the SO commodity charge be helpful? Is there any additional information required prior to publication?

Yes. In addition if the total allowed SO revenue is published in the same place it will ensure all elements of SO costs/revenues/incentives are readily available & assist in transparency & understanding.

Question 8.1 Would you like to make any other comments on SO incentives that have not been captured through the other questions in this document?

The analysis and investigations into CV shrinkage & system flexibility are on going and it is not appropriate at this moment in time to suggest incentive mechanisms. However, in time when the analysis is complete incentives could be suggested.

Question 8.2 Are there other areas where you believe there would be benefit from introducing a new SO Incentive?

In respect of demand forecasting, SSE believes the Non Daily Metered (NDM) component of the forecast is of particular value, as each shipper has to make separate DM and NDM nominations. We believe an additional incentive designed to improve the NDM component of the forecast should be introduced. As well as the introduction of seasonal average error and absolute forecast error incentives.

In respect of maintenance, when agreed dates are changed without mutual consent then NG NTS to incur a share of the lost revenue as a maintenance incentive.

Please do not hesitate to give me a call if you wish to discuss this further.

Yours sincerely

Jeff Chandler
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Energy Strategy