

Our Ref
Your Ref

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Dear Kyran

**Income adjusting event under National Grid Company's
2003/04 system operator incentive scheme**

We are pleased to have the opportunity to respond to this consultation on a proposed income adjusting event under National Grid Company's system operator incentive scheme.

We recognise the purpose of the income adjusting event provisions within the System Operator incentive scheme. However, we are concerned that there is an incentive for these arrangements to be used as a get out clause whenever the market conditions are not in NGC's favour. There is a risk that income adjusting events can undermine the purpose of the System Operator incentive scheme by skewing the degree of risk and reward that has been build into the scheme.

We do not believe that the supplemental standing reserve tender represented a deviation from the normal balancing activities of National Grid. Indeed it is stated in the "Explanation and Tender Guidance Document" that the supplemental standing reserve tender process is intended to allow NGC to "...meet its predicted level of Reserve requirement via the potentially more economic alternative to buying additional Reserve on the day in the Balancing Mechanism or by energy trading (eg. PGB Transactions)."

There were therefore two possible outcomes of this action by NGC:

1. The supplemental standing reserve tender did result in a more economic means of procuring reserve. In which case NGC has acted efficiently and achieved a greater level of incentive scheme reward than if it had procured this reserve on the day.
2. The supplemental standing reserve tender did not result in a more economic means of procuring reserve. In which case NGC did not act efficiently and should suffer a lower level of incentive scheme reward than would otherwise have been the case.

As normal standing reserve can be called upon within very short timescales but the supplemental standing reserve involved longer timescales we do not believe that the higher option fees contracted for supplemental standing reserve were logical or economically justified.

We would like to see further analysis undertaken by Ofgem into the likely costs of meeting the reserve requirements through normal on-the-day balancing mechanism and energy trading actions. However, in either event we do not agree that there is a case to approve the Supplemental Standing Reserve Tender costs as an IAE to the System Operator incentive scheme.

We hope that you will find these comments helpful. If you have any queries please contact me on 0207 752 2526.

Yours sincerely

Rupert Judson
Transmission Infrastructure
& Development Manager