Scottish and Southern Energy

Inveralmond House
200 Dunkeld Road
Perth
PH1 3AQ

Sonia Brown
Director, Wholesale Markets
Office of Gas and Electricity Markets
9 Millbank
London
SW1P 3GE

Telephone: 01738 456400
Facsimile: 01738 456415

Date : 18 April 2007

Dear Sonia,

**Re: National Grid Gas System Operator Incentives from 1 April 2007**

Scottish and Southern Energy plc (SSE) welcomes the opportunity to comment on Ofgem's final proposals for National Grid Gas plc's (NGG) system operator incentive. We have responded to the questions posed by the consultation but, in addition, we would like to make the following points.

Having recognised in 2006 the volume of work involved in proposing an industry-wide acceptable system operator regime, we were encouraged by Ofgem's efforts to initiate the process in July 2006. We are therefore disappointed that agreement has not been reached in time for the 1 April 2007 start date and that, if agreed, the final arrangements will have to be retrospectively applied.

Given that it is Ofgem's intention to carry out a full and extensive review of the external SO incentives before 1 April 2008, experience would suggest that work should start now. This is particularly important given the proposed five-year nature of the incentive scheme from 2008. Specifically, we believe that the gas reserve incentive would benefit from full and proper review to ensure that NGG's gas reserve volume requirements do not result in double provision of reserve and to ensure that NGG is procuring gas reserve in the most cost-effective and efficient way. However, as already stated in our previous response, dated 16 January 2007, we do not believe that a new incentive is necessary to limit methane emissions. We believe this is already adequately managed through the gas shrinkage incentive.

I hope this response is useful. If you have any questions or points of clarity, please do not hesitate to contact me.

Yours sincerely,

Rob McDonald
Director of Regulation.

1. **Do you consider that the final proposals for the SO incentive schemes to apply to NGG's external and internal SO costs represent a fair balance of risk and reward?**

   In terms of NGG's external SO incentive, we believe Ofgem has presented a very reasonable package of incentive targets and sharing factors, which should be acceptable to NGG. Going forward, we agree that the external SO incentive mechanism will benefit from total review and we look forward to contributing to this process.

   In particular, we would welcome a review of NGG's procurement of system reserve. The lack of breakdown on the *"other (non-LNG storage) locations"* has meant that we have been unable to determine whether the proposed costs outlined in the consultation document are appropriate and proportionate to the service.

   In relation to the specific changes for the coming year we welcome Ofgem's proposal to introduce a 'banded' approach to the gas shrinkage incentive. In National Grid's NTS SO incentive performance to date paper, NGG is shown to have outperformed its gas shrinkage target in 2003/04 and in 2004/05 by c.£17 M, thereby earning its full £4 M revenue in both these years.

   In terms of the internal SO incentives, we have always found it difficult to comment on the appropriateness of the target costs without sight of NGG's detailed costs. However, we welcome the latest steps taken by Ofgem to avoid double-counting pension costs and to introduce a 'fixed strength incentive'. Consistent with this, we consider the sharing factors to be reasonable.

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

   It would appear that the proposed licence modifications appropriately reflect the final proposals.