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Dear Philip,

Re: National Grid Electricity Transmission and National Grid Gas System Operator Review

Scottish and Southern Energy plc (SSE) welcomes the opportunity to input early in the design of National Grid Electricity Transmission's (NGET) and National Grid Gas's (NGG) system operator (SO) incentive arrangements from 1 April 2008. Ofgem raised a number of areas worthy of review during its consultation on the implementation of the 2007/08 incentives and, given the difficulties in implementing the arrangements in recent years, we consider Ofgem's current review to be both appropriate and timely.

We are aware that reviews in some areas are already underway, for example in the frequency response and reactive power market, and we support these. These are two high cost areas that attracted considerable comment during the 2006/07 review and it is likely that proper review of these elements will take time. Consistent with this, we support Ofgem's recognition that it *"may not be feasible for all elements […] to be finalised in time for implementation in April 2008"*. We believe this presents a more pragmatic and realistic approach than previously presented, and the appointment of two work streams in order to deliver the near-term and longer-term objectives appears to be an appropriate and manageable way forward. We look forward to inputting further on how Ofgem proposes to divide and plan for this work.

In its letter dated 18 May, Ofgem outlines *"a number of ongoing issues that will need to be considered in parallel"*. We appreciate that this letter is not intended to be a complete list at this stage. Nevertheless, we believe it is worth mentioning the CUSC amendment proposal (CAP) 148, which, if implemented, would give renewable generators deemed access rights to the GB transmission system. Clearly, this would have an impact on NGET's SO incentive. We believe its potential impact (along with the potential impact of the cash out review and work ongoing within the Balancing Services Standing Group) should be considered as part of this review from the outset. In addition, in its review of NGG's SO incentives, Ofgem should take into account the changes being implemented in the gas access arrangements. These reforms will change the way the market operates and the incentives should reflect this.

On the terms of reference, we believe that Ofgem's appendix sets out a robust suite of areas and issues that should be considered as part of the review process. We would, however, like to make the following two comments:

- We note that one of the terms of reference identified by Ofgem is the scope for consistency between NGET's and NGG's SO incentive schemes. Although consistency would be welcomed where natural parallels exist, we believe the emphasis should be more on recognising and understanding the interactions between the two incentive regimes and whether or not opportunities exist for NGET and NGG to optimise their performance.

- We believe there is a risk that over time the individual incentive parameters become enshrined in the incentives without good reason, i.e. circumstances change but the rationale for setting the parameters is not revisited in the detail necessary to determine whether they are still appropriate. With over 6 years experience under NETA, we believe there should be sufficient information regarding likely values and revenues under the regime to reassess what is appropriate and reflective. We would therefore strongly encourage Ofgem to undertake a thorough review of the parameters with a view to updating them and making them more transparent going forward.

We hope this early feedback is useful and can be reflected in Ofgem's 'initial thoughts' document, which we look forward to reviewing in due course. In the meantime, should you require any additional information or clarity, please do not hesitate to get in contact.

Yours sincerely,

Rob McDonald
Director of Regulation.