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Dear Malcolm,

System Operator Incentives for 1 April 2010

Following the publication, on 15th December 2009, of the “Development of Constraints Forecast 2011/12” addendum we noted the direct, and material, linkage to numerous questions arising from the “Initial Proposals Consultation” (issued on 5th November 2009). We have therefore taken the deadline for the addendum (of 22nd December 2009) as being the deadline for responding to the consultation.

The late provision of this second year constraint data (with such a short time to respond – less than seven days) has, in our view, materially harmed our ability to respond to this consultation.

Given that many people have started their Christmas holidays last Friday (18th December) we fear that you will receive very limited responses, especially on the matter of the costs of constraints over two years. Were NGET, and Ofgem, to rely on this flawed consultation process to decide and implement a two year incentive regime (covering 2010/11 and 2011/12) then it would be a travesty and call into question the whole approach to the SO Incentive consultation process. The implications etc., of such a fundamental change (from a one to a two year regime) requires more consultation etc., than the mere seven days afforded here.

In terms of the details, as you will have gathered from our recent telephone conference, our main area of interest is in the forecast cost of constraints. This is therefore the focus of this response. We have provided responses to the questions where relevant, but would initially like to make the following comments.



Level of Constraint Forecast compared to 2009/10

The forecast for constraint costs for 2009/10 made by NGET at this time last year was £307m. NGET's latest forecast is that it will outturn at some £206m, some 67% of the original forecast. Scotland constraint costs started at £242m and are now forecast at £151m only some 62% of the original forecast. It would seem therefore that the NGET forecast for 2010/11, of GB constraint costs of £477m is likely to come down, and if like last year would come down to an outturn of some £320m. Scotland's constraint cost would similarly come down, for 2010/11, to a pro-rate level of £180m (rather than £290m).

Summer outage programme

It has been stated by NGET that the greatest constraint costs appear during the summer outage months, yet the level of these GB constraint costs through the summer of 2009 (April to October) has only actually been some £107m. Allowing a further £15m for November 2009 and £15m for March 2010 (based on £107m divided by 7 months equals ~£15m per month on average) would suggest a total constraints costs, for 2009/10, of some £137m for the year during the outage period. It is not clear therefore to us where the costs of the other ~£69m (£206m less £137m) comes from for NGET's forecast outturn constraint costs (for 2009/10).

If the £206m is 'correct' it implies that the cost of constraints, over the three remaining winter months (December 2009 – February 2010), will be in the order of ~£23m per month (£69m divided by 3) which is significantly higher than the levels so far experienced (in 2009/10) for the summer outage period (at circa £15m per month – see above). This we find very hard to believe, and it suggests that the base level of constraint costs is substantially less than the latest NGET forecast level of £206m.

Inconsistency in approach

There also seems to be an error in the way that the split of these costs have been used in the document. In paragraph 454, £209m is quoted as the scheme forecast for Scotland for 2009/10. To this is added some £81m as the additional costs that will be incurred due to increased generation, a larger outage programme etc. to give the total, for 2010/11, of £290m for all Scotland.

However as noted, the latest forecast is only some £206m for the whole of GB, split in NGET's "Historic and Forecast Balancing Services Incentive Scheme Costs" to £151m for Scotland. We do not believe it is appropriate to base the forecast for next year (2010/11) on the forecast that was made a year ago, ignoring the actual outturn costs over the summer of 2009 and the latest forecast for constraint costs for 2009/10.

In addition, instead of using a scheduling model, NGET base their forecast on historic levels, plus Monte Carlo simulation to create the generation running pattern. However, it also appears that the historic pattern is modified (to what NGET believe will happen) by removing 2008/09 data as during this period they had contracted constraint management services. We do not believe it is appropriate to ignore (in the 2010/11 forecast) the contacting arrangements that NGET put in place in 2009/10.



Level of New Wind Generation

We believe that the level of wind farm connections, in the forecast, is significantly too high. We have been led to believe that the assumption made by NGET is that some 99% of the generation coming on is located in Scotland, some 1200MW. We do not believe that this level of wind generation due to connect is realistic.

For 2010/11, NGET's latest forecast of TNUoS charges (Information Paper – 5 year forecast of TNUoS tariffs – December 2009) only has some 400MW connecting in Scotland, and we believe that even this is too high for the calculation of constraints. Take, for example, a 200MW windfarm coming on mid 2010. For 2010, whilst the first connection may be made in 2010, it will take some 2 years to complete the construction and commissioning of the whole 200MW of generation at that site. This would suggest only some 50MW in 2010. This would reduce the 400MW down to 250MW for 2010/11. However, even using 400MW and pro-rating, the additional costs of new generation would come down from some £43m to some £14m, a reduction of £29m.

Constraint implications arising from Locational BSUoS

We do not comment on the merits or otherwise of the proposed Locational BSUoS (GB ECM 18) change. This is currently the subject of a separate Ofgem Regulatory Impact Assessment consultation, which we will respond to in due course.

We note that, in NGET's stated view, the effects of Locational BSUoS is that constraint costs would decline by between 50-80% (slide 13, from the DECC Grid Access Reform Stakeholder Events 15 October–London 26 October –Glasgow, “National Grid analysis: Locational BSUoS reduces total constraint costs on Cheviot boundary by 50-80%”).

For the avoidance of doubt, if Locational BSUoS (GB ECM 18) were to be implemented on the dates recommended by NGET (1st April 2010) then we would expect an Income Adjusting Event to be raised to ensure that NGET, as SO, does not materially benefit from such a change.

Contracting for Constraint Management Services

There is a clearly a driver for NGET not to enter into contracts whilst discussions are ongoing about the level of the SO Incentive for next year. In addition, the regulatory uncertainty of the potential for Locational BSUoS (GB ECM-18) and CAP 170 to be implemented makes NGET reluctant to contract ahead (they could get the service for nothing). These though create a false impression of what the constraint forecast will be and what NGET will be able to achieve under its incentive scheme. Nonetheless, given the level of contracting NGET successfully completed in 2009/10, we believe that this must be taken account of in the forecast for 2010/11.

Conclusions on level of Constraints in Scotland

There is a range of what the costs of constraints are likely to be in Scotland, which is significantly lower than the £290m being claimed here.



The first is the pro-rate as above, based on the latest forecast outturn costs for 2009/10. This would suggest a level of Scotland constraint costs of £180m.

The second is estimated from the assumption that the forecast of Scotland constraints for 2009/10 is reasonable at £151m (though it does not compare well to the level of costs over the summer outage period) and adding the lower level of costs for additional new generation of only £14m. The additional costs for increased margin and what would appear to be a more onerous outage plant would remain, and this would take the total cost for Scotland to only as high as £203m.

Conclusions on Constraints Forecast

Our total (GB) constraint estimation (using information provided by NGET and for the reasons we outline in our response) based on using the actual data to date for 2009/10 (rather than last year's forecast for 2009/10) is £326m.

This is based on:

- An estimated 2009/10 outturn, for GB constraint costs, of £137m (£107m + £15m November 2009 + £15m March 2010)
- To this we have added an estimated increase of £52m for Cheviot & Scotland (£81m - £29m due to lower wind)
- We have then added in the NGET forecast, for England & Wales constraint costs, of £137m

However, it is clear (for the reasons we outline elsewhere in this response) that this is our upper forecast as it does NOT include the efficient contracting as NGET has, for example, already achieved in 2009/10. From the information available to us, this would suggest that our £326m figure should be even lower.

We hope you find these comments helpful.

Yours sincerely

David Fernie
EMC Manager