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Dear Giuseppina

System Operator Incentive Schemes from 2013

Thank you for providing SSE with the opportunity to comment on the above consultation. We have provided our responses to the consultation questions below.

1. Do you consider that the general principles we have used are appropriate?

Yes.

2. Do you consider that we have identified all the relevant outputs for the electricity SO?

Yes.

3. Do you consider that we have identified all the relevant outputs for the gas SO?

Yes.

4. Please provide your views on which of the outputs of both the electricity and gas SOs should be incentivised.

We believe that the following outputs should be incentivised: GHG Emissions; Residual Gas Balancing; Demand Forecasting; NTS Shrinkage; Capacity Buyback; OM and Maintenance Scheduling.

Energy Not Supplied
Whilst in principle we believe this incentive proposal may have merit, we have serious reservations as to how, when NGET act as both the SO and TO, it could be implemented without creating a perverse incentive for NGET to 'slice and dice' the overall restoration time in order to maximise their income under the TO and SO incentive schemes.

If such an incentive were introduced, we assume that the historic performance of the SO, in terms of customer minutes lost attributable to their action (or inaction), compared with the actions of the TO, would be used by Ofgem to set the initial benchmark against which the SO's performance will be measured, and thus incentivised. Without this historic performance information we are unable to provide comment in regards to the benefits or costs of an Energy Not Supplied SO incentive.

If Ofgem wish to pursue the introduction of an SO Energy Not Supplied incentive, we believe that the historical information (in terms of customer minutes lost attributable to their action (or inaction) compared with the actions of the TO) should be published, along with details of how Ofgem plan to mitigate the potential incentive to 'slice and dice', in the next consultation paper published as part of the SO Incentive Schemes from 2013 consultation process.

Maintenance Scheduling
We welcome the proposal for the introduction of a new Maintenance Scheduling Incentive as we strongly believe an incentive is required to improve performance in this area. Our particular concern is in regards to NGG giving only 30 days notice when changes are made to an agreed scheduled maintenance date.

When NGG change the scheduled maintenance date, it is not always possible to reschedule the power station maintenance which has been scheduled to align with NGG's maintenance date. As a result, the power station is forced to have two separate maintenance outages: one for NGG's work; and one for specific plant related work. Power station maintenance is often undertaken by third party specialist contractors who need to be booked months/years in advance. The revenue lost when a power station has no gas supply and is unable to generate, is dependent on the spark spread, but can be multiples of £100,000/day.

Given the significant lost revenues that are incurred by generators when they are unable to generate, we believe NGG should be incentivised to keep to the originally scheduled maintenance date, (unless agreed in advance by mutual consent). If NGG does change the maintenance date, then NGG should be required to reimburse if not all, at least a proportion, of the losses incurred by the generator. The lost revenue could be calculated using a standard market rate or specific costs based on open book disclosure.

5. Do you agree that it may be more appropriate to place licence obligations (funded through the internal gas SO incentive scheme) with respect to UAG and / or Information Provision?

As we have historically believed that NGG's information publication should be treated as a routine requirement rather than an action to be incentivised, we support the proposal to replace the current information publication incentive with a licence requirement.

It is clear that the current UAG incentive has proven ineffective at significantly reducing the volume of UAG. However, we understand that this is a complex issue to address and therefore are not confident at this time that a licence condition would be the most appropriate measure to take. Rather than consider a licence requirement at this time, we would suggest that Ofgem request that NGG provide a range of alternative measures, which can be consulted upon within the next stage of the 2013 SO incentives consultation process.

6. Is there a need for greater incentivisation of NGET and NGG with respect to customer satisfaction? If yes, what form should this incentivisation take?

We understand the proposal to introduce Customer Satisfaction incentives, is being addressed via the RIIO-T1 price control. We believe that if any concerns remain after this process has concluded, it would be appropriate to revisit the potential introduction via the 2013 SO incentives consultation process.

7. Do you consider that the reasons we have proposed for bundling are reasonable?

Yes.

8. Do you consider that the options for bundling are reasonable? Are there any additional options that we should be considering?

Yes.

9. Do you consider that, based on the current outputs that are incentivised, continuing to bundle the electricity SO scheme is appropriate?

We support the principle of bundling in the electricity SO scheme. However, we are concerned that under the current incentive regime, NGET is not only being over-rewarded for certain actions, (as NGET is rewarded for these actions under numerous outputs), but that NGET is also being incentivised via the SO scheme to carry out activities which are actually licence obligations.

We note the reference in paragraph 4.5, to a 'double impact' i.e. one action has a positive impact on more than one output. It is worth noting that there is in fact the possibility of actions having a 'triple impact'. We believe this triple impact occurs when the SO accepts a licence obligation to perform task X in an economic and efficient manner and is remunerated accordingly, but is also incentivised under the SO scheme to perform task X in a least cost way i.e. in an economic and efficient manner.

For example in regards to energy balancing and constraint management, it is not clear that some, or all, of the actions required by this incentive are not in fact, part of the SO's general duties to perform (in an economic and efficient manner in accordance with good industry practice) as part of their non incentivised 'day-to-day' costs charged to stakeholders.

To address these concerns and improve transparency, we believe it would be appropriate for Ofgem to publish an annual report detailing the total revenue NGET received from stakeholders to perform its SO licence obligations, and of that total, how much was incentivised (with the maximum 'upside' and 'downside' figures also shown) for each element of the scheme.

10. If you consider that the electricity SO should be incentivised on additional outputs, should these be part of the same bundled scheme? If not, how should the incentives be packaged?

If NGET were to be incentivised on new additional outputs, it would be appropriate for those new incentives to form part of the bundled scheme in the long run. However, depending upon the output, it may be appropriate for it to be treated as a separate incentive (similar to the gas incentive scheme) until Ofgem are confident that the incentive is set at the appropriate level.

11. Do you consider that there is merit in increasing the number of gas outputs incentivised through a single scheme?

We share Ofgem's concerns that the existing fragmented approach to gas incentivisation may not always provide the most effective signals to the SO. In principle we agree that there may be merit in increasing the number of outputs incentivised through a single scheme. However, we are concerned about the loss of transparency that may result if robust monitoring and reporting of individual components is no longer available.

12. How do you consider the outputs of the gas SO should be incentivised?

We believe the current incentivisation methodology has worked well to date. However, as raised in our response to question 9, when bundling outputs, in order to ensure NGG is not over-rewarded, Ofgem must ensure that a single action is not rewarded under numerous outputs, and that it is not incentivised via the SO incentives scheme to carry out activities which are actually licence obligations.

13. How do you consider that the incentives on the gas SO should be packaged?

For the 2013 incentive period, it may be appropriate to apply financial bundling via combining sharing factors, cap and floor, but keeping all incentives separate, with corresponding separate targets. However, we cannot take a position on the introduction of this methodology until further details have been provided.

As highlighted in our response to question 9, it may also be appropriate for Ofgem to publish an annual report detailing the total revenue NGG received from stakeholders to perform its SO licence obligations, and of that total, how much was incentivised (with the maximum 'upside' and 'downside' figures also shown) for each element of the scheme.

14. Have all the benefits associated with moving to longer term incentive schemes been captured?

Yes.

15. Can longer term SO schemes be implemented through the different approaches discussed, year by year incentives and multi year block incentives? What do you consider are the relative merits (or otherwise) of each approach?

We support the principle of moving to a longer term SO incentive scheme for both gas and electricity. However, we only support the move if the incentives are proven to be appropriate and effective.

We recognise that multi year block schemes provide greater incentive for initiatives which pay back over a longer period than year by year incentives. However, until the electricity SO incentive methodology (which was introduced this year) has been proven effective, and if any changes are introduced to the gas SO scheme, those are also proven effective, we believe that the use of a year by year scheme would be the most appropriate solution.

It is also important to note that the European Network Codes, which are expected to be implemented in 2014, are highly likely to directly impact upon the SO incentive schemes. We believe a year by year scheme would provide Ofgem sufficient opportunity to alter the SO incentives if any changes were required.

16. Is our proposed treatment of uncertainty and risk associated with longer term schemes reasonable? If not, please explain how this can be improved.

Yes. However, it is important that the SO incentive schemes are designed in such a way that they align with the European Network Codes.

17. Do you consider that it would be of overall benefit to consumers to better align the incentives of the SOs and the TOs?

It should be noted that SO TO interactions are currently taken into account in the existing regulatory framework. For example in electricity, there are provisions through the TSS funding mechanism and SO driven investment requests. There are also existing outage cost sharing mechanisms and coordination rules in the STC.

We agree with the principle that improvements made to the alignment between the SOs and TOs are likely to result in benefit to consumers. However, we believe it would be highly inappropriate to provide an economic incentive to drive SO-TO interactions as we believe this to be an integral part of the operator's role.

18. Please provide your views on the extent to which better alignment can be achieved through the alignment of the incentive schemes under the same and separate ownership.

We believe better alignment could be achieved if SOs were to more actively review the TOs investment plans at an early stage to assess the system operation impact. If the current level of alignment is not deemed to be sufficient between these parties, an obligation, rather than an incentive, should be imposed.

19. Please provide your views on the economic incentives to drive SO-TO interactions ("payment mechanism"). In what areas could this principle be usefully applied?

We believe it would be highly inappropriate to provide an economic incentive to drive SO-TO interactions as we believe this to be an integral part of their activity. If the current level of alignment is not deemed to be sufficient between these parties, an obligation rather than an incentive should be imposed.

We hope you find this information useful. If you would like to discuss any of the points raised in more detail, please do not hesitate to contact me.

Yours sincerely

Claire Rattey
Regulation