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Dear James,

Proposed Income Adjusting Events (IAE) submitted by National Grid Electricity Transmission in relation to the 2011-13 Electricity System Operator Incentive Scheme

We welcome the opportunity to comment on Ofgem's open letter regarding National Grid Electricity Transmission Plc's (NGET) application for the following four Income Adjusting Events (IAEs) during the 2011-13 System Operator (SO) incentive scheme:

1. The closure of the Alcan plant in December 2011 and NGET's subsequent loss of its Static Low Frequency tripping service. Financial impact: £38.3 m;
2. The unplanned and unforeseen outage of Moyle interconnector for an 8 month period. Financial impact: £29.2 m;
3. The FMJL replacement works at Smeaton and Strathaven substations on operational and safety grounds. Financial impact: £28.9 m;
4. Outturn losses under the scheme's Transmission Losses incentive exceeding the target / forecasts. Financial impact: £107.9 m.

Having reviewed NGET's supporting papers and the IAE criteria set out in NGET's transmission licence (special condition AA5), our view is that whilst at least elements of two of the above events qualify under the IAE criteria, neither (1) – the closure of the Alcan plant - nor (4) – the missed target under the transmission losses incentive – are eligible applications.

Inherent in any incentive scheme is some degree of risk. Whilst the closure of the Alcan plant is a commercial decision by a connected party and is outside NGET's control, NGET is suitably placed to negotiate with other potential providers and to put in place alternative arrangements. NGET would have had at least some prior notice of the plant's closure, if not through direct contact with Alcan, at least through the media, in which to take appropriate action. The fact that, in this instance, NGET was unable to put in place alternative arrangements at the same or similar cost to the Alcan contract is, we would argue, a risk that rests with NGET under the incentive scheme. In another set of circumstances, NGET might find itself able to negotiate more favourable contractual terms, thereby benefitting under the incentive scheme.

In any case, from the information provided the costs attributed to the closure of the Alcan plant appear to us to be very expensive. As we understand it, the service provided by Alcan

was for low frequency tripping at 49.7 Hz. However, in replacing this service, NGET appear to have priced according to normal frequency control.

In terms of the transmission losses incentive, in agreeing to the 2011-13 SO incentive scheme, we believe NGET agreed to the risk that comes with this incentive and the setting of an *ex ante* target. We note that the current SO incentive scheme no longer features a financial transmission losses incentive because it is now considered an area where the SO (and indeed TOs) have limited influence. However, we question whether we would be having this discussion had transmission losses during the 2011-13 period resulted in positive revenues to NGET. Moreover, we believe it is an unwelcome precedent for incentive schemes to be retrospectively 'pulled' given that these are part of a carefully balanced settlement between the licensee and Ofgem.

Therefore, for the avoidance of doubt, we do not believe that any element of the above events (the closure of the Alcan plant or the missed target under the transmission losses incentive) should be considered under the IAE principles.

The unplanned outage on the Moyle interconnector is, in our view, less straight forward. Whilst this is a more credible application, we believe there are two issues that weaken this application. Firstly, this outage should not have been wholly unexpected given the Moyle interconnector's recent failure rates. Secondly, whilst the interconnector's outage meant that flows across the Moyle were reduced, the running regime at Peterhead was coincidentally significantly lower than NGET would have been expecting. We would have expected this to have countered most of the Moyle impact.

Finally, we believe the FMJL replacement works is a valid application. From the information provided, it would appear that these works fall beyond the reasonable control of NGET and, as such, could be considered as constituting force majeure. It strikes us as reasonable that the replacement works, whilst affecting two different substations, could be considered a single IAE.

The above hopefully clearly sets out our view that any income adjustment due to NGET as a result of these events should be much reduced from the total presented in Ofgem's open letter. Nevertheless, we would welcome clarity from Ofgem in terms of how any resulting changes to BSUoS will be applied to ensure that these are fairly apportioned and 'picked up' by the 'right' parties.

I hope this is useful input. Should you wish to discuss any of the above, please do not hesitate to get in touch.

Yours sincerely,

Gillian Hilton
Regulation.