



Grampian House
200 Dunkeld Road
Perth
PH1 3GH

Leonardo Costa
System Operation
Wholesale Markets Performance
Ofgem
9 Millbank
London
SW1P 3GE

Telephone: 01738 453482

Email: robert.hackland@sse.com

Date : 16th January 2014

Dear Leonardo,

Funding arrangements for new balancing services: Initial Proposals

Thank you for the opportunity to respond to this consultation. We have provided answers to the questions posed in the attached annex, but would like to, in addition, make the following points.

We agree that it is not appropriate to put in place financial incentive arrangements at this stage for the two years of SBR and DSBR services, 14/15 and 15/16. However, should the services extend beyond 15/16 the knowledge of the procurement and use of the services should be used to set targeted financial incentives going forward.

We agree that targeted efficiency checks are, at this stage, a more appropriate way of ensuring transparency and efficiency in the provision and use of these services by NGET. Whilst we agree that both volume [capacity] caps and forecast requirements should be set out ex-ante and that NGET should work within these, we believe that it is more important for NGET to set out the methodology for the 'all in' costs of procuring and utilising these services and work within these. NGET should use their forecast requirements of volume [capacity], utilisation, pre-utilisation and testing to assess tenders, with the assessment made against a loss of load expectation at the value of lost load (VOLL). For this we believe that domestic customer VOLL should be used of £17/kWh. As well as NGET working within the volume [capacity] cap and requirements, the ex-ante values for utilisation, pre-utilisation and testing used in assessing the overall least cost procurement of tenders, should be used ex-post to assess NGET's allowable pass through of costs. These ex-ante forecasts would also provide the market with a view of the likely costs of the services.

With regard to the internal funding costs, these appear disproportionately high relative to the estimated costs of the services and particularly as the estimated service requirements have been reduced for both 14/15 and 15/16. In addition, it has been acknowledged that

NGET are already allowed £1million per year for unforeseen costs. This should be taken account of in the payment of National Grid's SBR/DSBR set up costs.

I hope you find these comments helpful.

Yours sincerely,

Robert Hackland

CHAPTER: One

Question 1: *Do the draft licence conditions published alongside this document appropriately reflect our initial proposals?*

It has been acknowledged that NGET are already allowed £1million per year for unforeseen costs. This should be taken account of in the payment of National Grid's SBR/DSBR set up costs and therefore should appear in the licence conditions. Otherwise, they seem appropriate.

Question 2: *Do you agree with our assessment that a financial incentive would not be fit-for-purpose at this time?*

We agree that it would be difficult to set an appropriate financial incentive for the initial two years of the SBR and DSBR given there is no history of the service. However, should the service extend beyond 15/16, the knowledge of the procurement and use of the services should be used to set future targeted financial incentives.

CHAPTER: Two

Question 1: *Do you agree with our approach towards funding for the internal costs associated with the services?*

We agree with the approach on funding for internal costs. With regard to the level; of internal funding costs, these appear disproportionately high relative to the estimated costs of the services and particularly as the estimated service requirements have been reduced for both 14/15 and 15/16. In addition, the £1 million that NGET are already allowed per year for unforeseen costs should be taken account of in the payment of National Grid's SBR/DSBR set up costs.

Question 2: *Do you agree with our view that the targeted efficiency check protects consumers and increases transparency to industry?*

We agree that the targeted efficiency checks will help protect the interests of consumers and increase transparency.

Question 3: *Do you agree with how we have proposed to fund each of the cost components of SBR and DSBR?*

The approach is reasonable.

Question 4: *Do you have any views on NGET's proposed approach towards identifying a volume cap and volume requirement?*

We agree that there should be both a volume [capacity] cap and a forecast volume [capacity] requirement. These would help provide the market with a view of the likely costs of the service. A cap of 5% of ACS demand seems reasonable. The volume requirement should be set taking account of the loss of load expectation and the value and cost of procurement of the services relative to the value to consumers, i.e. their value of lost load.

Question 5: *Do you agree with the principles behind each of the ex ante methodologies and any proposed details that we or NGET have suggested should be included within the methodologies?*

We agree with the principles behind each of the ex-ante methodologies put forward by Ofgem.

In relation to the volume (availability and utilisation) to be procured we agree that no service should be procured where the overall forecast outturn would be above the value of energy unserved and we agree with NGET that this should be set at domestic VOLL of £17/kWh.

In relation to the testing methodology, it would be important to test both SBR and DSBR services, but in particular DSBR given the uncertainty surrounding how it may respond. This should be regardless of the overall costs of carrying out the DSBR tests. It should not be the case that DSBR is not tested (yet would be paid an availability payment) simply because it is too expensive to test. It should be a requirement on NGET that only economic and efficient DSBR services are procured and that this should include economic and efficient testing requirements. With respect to SBR, it is imperative that SBR tests are carried out in a manner that minimises the impact on the market.

In relation to pre-utilisation and utilisation, it is imperative that both should only be used as a last resort. It is also important that NGET should have an expectation of the utilisation of the SBR services in order to establish the least cost outcome in assessing the tenders. As noted above, there should be an overall ex-ante forecast requirement against which NGET's allowable pass through costs would be assessed ex-post. These ex-ante forecasts would also provide the market with a view of the likely costs of the services.

Finally, it is important that Ofgem are able to ensure that the costs of services under this "targeted efficiency check" arrangement are readily identifiable and kept separate from costs incurred for services under NGET's incentivised scheme, BSIS.

***Question 6:** Are there any other principles or details that should be included within our targeted efficiency check approach?*

Not at this moment.