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Dear Martin,

Revenue, Incentives and Outputs for National Grid's Role in Electricity Market Reform

Thank you for the opportunity to respond to this consultation. We have included the answers to the questions posed in the attached Annex.

It is appropriate that NGET are both allowed to recover their costs and are suitably incentivised on their role in EMR over the first 20 months of EMR to March 2016. It is unfortunate that the timing of their starting their role does not allow sufficient time for costs, outputs and allowances to be set for 2014 other than on a provisional basis. Nevertheless, it is appropriate that provisional arrangements are put in place and those proposed here seem reasonable and pragmatic, balancing the needs of NGET with those of customers and at the same time being proportionate to the overall level of costs.

We look forward to being able to comment on NGET's final business plan in due course.

Yours Sincerely

Robert Hackland

Consultation questions **ANNEX**

Provisional Allowances

CHAPTER: Two

Question 1: *Do you agree that we should allow NGET provisional funding subject to the receipt of a well justified business plan?*
Yes. It seems reasonable and pragmatic to allow NGET provisional funding, subject to the receipt of a well justified business plan, rather than have them not receive monies until April 2016.

Question 2: *Do you agree that we should not allow an adjustment to reflect the time value of money if NGET do not meet the September 2014 submission date?*
Yes. Again it seems a reasonable and pragmatic solution to keeping NGET incentivised to meet the September 2014 submission date.

Question 3: *Do you agree that the £5m proposed cost allowance is reasonable?*
It is extremely difficult to comment on the level of proposed cost allowance given the lack of transparency of information that makes up this cost. Whilst the estimated costs provided by NGET may be their best view, they are clearly very uncertain at this stage and therefore it is reasonable that in providing funding early to NGET (i.e. in 2015 rather than 2016) some provision is made to account for this uncertainty of cost. On that basis £5m seems a reasonable figure as a provisional allowance.

Provisional Outputs and incentives

CHAPTER: Three

Question 4: *Do you agree with the incentives we are proposing?*
Yes. It is important that NGET have some form of financial incentive on them in delivering the outputs of their EMR functions. It is also important that the incentives do not provide NGET with any perverse drivers in carrying out their role. The combination of NGET being allowed to have one decision overturned in each category with no financial reward or penalty along with offsetting rewards and penalties in different categories will help minimise any perverse incentives. It is appropriate that the rewards/penalties are based on the notional administrative costs of dealing with disputes, and on the basis that these estimates are accurate, then the level of financial penalties/rewards seems appropriate. The publication of information on NGET's performance in carrying out their EMR functions and the risk to their reputation of failure will bolster the financial incentives to be put in place.

Business Plan and Assessment

CHAPTER: Four

Question 5: *Do you agree with our proportionate approach to the assessment of the business plan including provision of different scenarios?*
Yes. We agree that given the relative level of costs, the assessment of NGET's business plan should be proportionate to this level of costs. We also agree that the use of scenarios would, in this instance, provide some benefits in being able to assess the business plan given the uncertainties that will surround the role only a couple of months after 'go live'.

Question 6: *Do you agree that the capitalisation rate for internal SO costs should also apply to EMR enduring costs?*
The use of the same capitalisation rate seems appropriate in the circumstances.

Licence Changes
CHAPTER: Five
Question 7: *Do you agree with the proposed licence changes?*
The proposed licence changes seem reasonable.

Question 8: *Do you agree with the proposed Financial Handbook and PCFM changes?*
The proposed changes to the Financial Handbook and PCFM seem reasonable.