

Ian Pashley
National Grid
National Grid House
Gallows Hill
Warwick
CV34 6DA

Telephone: 01738 457909

E:mail:Jeff.chandler@
scottish-southern.co.uk

Our Reference:
Your Reference:

Date : 30 Sep 08

Dear Ian,

Operating Margins Contestability & SO Incentive Arrangements

SSE welcomes the opportunity to comment on the above consultation document and offers the following comments to help progress the development.

In principle, SSE is supportive of extending the potential sources of Operating Margins (OM) provision with the goal of reducing the cost of the service. However, SSE notes that a number of the options proposed by NG introduce additional uncertainty and risk and require more complex arrangements. SSE is concerned that increased levels of up to 150% may need to be procured from some of the potential new service providers such as NTS Connected Loads, Offshore Supply and Interconnectors, in order to deliver the same level of certainty as is currently achieved through storage. We are concerned that the risk / reward profile of providing such a service from new participants may be such that the potential benefits to the market are marginal. Indeed we are concerned that based on information currently available, the overall cost of providing OM services could increase. This would be entirely inappropriate and completely at odds with the principle behind introducing competition.

With respect to CCGTs operated by SSE we may be reluctant to offer OM services far ahead of physical delivery as this will remove the option to allow them to generate at times of high spark revenues. CCGTs have been invested in to capture the spark and provision of OM services will be a lower value priority. The historic levels of expenditure to attract OM services may be insufficient to pay for the CCGT option fee. Those plants with back up fuel may be more willing to offer OM services but if Universal Firm Exit Reform is implemented we would anticipate a decline in the number of sites that would maintain a back up fuel option.

The risk premium to forgo the generation option will be higher the further ahead of time it is contracted for to reflect greater uncertainty. In addition, CCGT generation operation is dependent on a number of factors making a maximum and minimum offtake rate difficult to

commit to far ahead of time. By contracting on a shorter term basis more interest from CCGT's for offering OM services might be gained.

SSE believe that OM utilisation from CCGT demand would need to be based on OPNs. Taking the prevailing offtake rate at the time of OM utilisation and assuming a constant level for a specified duration will introduce forecast errors as CCGT output and fuel consumption changes on an intra and inter day basis. This will make the OPN take on commercial implications and this is beyond their original intended purpose. However, SSE view the OPN as the most pragmatic solution available at this time.

Regarding penalties for failure to reduce demand or supply gas from storage we believe they should be capped at the value of the OM contract. An uncapped liability will discourage the offering of services from all sources.

If Contestability is introduced but does not produce the anticipated results then SSE agree that a greater fraction of the total requirement should be secured from non-LNG storage. Not least because we expect more storage facilities to be commissioned in the future.

SSE believe that another 1 year incentive similar to now should be introduced until so that the impact of contestability can be assessed. It would be helpful to have more information on OM target volumes and costs compared to actual incurred to review performance and whether adjustments to the incentive require to be made. The 07/08 figure shows outturn very close to target (target was £26m) but we are unable to tell whether volume and the cost per unit has increased or not.

If you would like to discuss any of the above please do not hesitate to contact me.

Yours sincerely,

Jeff Chandler
Gas Strategy Manager
Energy Strategy