

National Grid Gas Transmission Gas System Operator incentives Stakeholder Engagement Consultation

This document provides you with a response template to our SO incentive consultation which sets out our high level initial thinking for the proposed System Operator (SO) RIIO-T1 gas incentives which will operate from April 2013. We welcome your views on these proposals and have asked a number of questions to which you may wish to respond. By providing us with your views, we will be able to deliver incremental change and drive out further benefits in terms of value and performance for our customers which are in step with the evolving use of the network, the developing gas market and the needs of our stakeholders.

We request that you provide your response to this consultation by **5pm on Wednesday 9th May**. When responding can you please provide us with your name, contact details, the name of the organisation you represent and whether your response is confidential. Please send your response to soincentives@nationalgrid.com.

Workshops are being held in early May to provide you with the opportunity to discuss these thoughts and proposals, prior to submitting your views in response to this consultation.

- The workshop on 1st May is intended to cover the capacity and connections incentive proposals. This will take place at the forthcoming Transmission Workgroup issues meeting arranged through the Joint Office.
- The workshop on 3rd May will focus on the 'System Operation' and 'Market Facilitation' aspects.

We would be pleased to welcome you at these workshops where you will have the opportunity to discuss the incentives with us. The invitations to the workshops can be found in the appendix section of the main Gas SO incentive consultation document.

If you have any queries, or wish to register for the workshops, please email soincentives@nationalgrid.com or call Juliana Urdal on 01926 656195 or Phil Lucas on 01926 653546.

Responder's Details

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Is your response confidential? No

System Operation

Residual Balancing

Q1. Do you agree with our proposal to maintain the current Residual Balancing incentive structure of linepack and price performance measures in preference to a cost minimisation scheme?

Yes, in order to avoid unnecessary distortions in the balancing market.

Q2. Do you support the proposed change to link price and linepack targets to market volatility and imbalance? If not, how do you consider a performance measure should be set?

No. Only limited information has been provided to support this proposed change, so we are unclear what the benefits would be. Shipper incentives and penalties do not flex to accommodate market volatility so we do not see the case for National Grid being treated differently in this regard.

Q3. Does our proposal of a daily maximum value (£9,240) represent a suitable potential reward for our residual balancing performance? If not, what value do you attribute to the Residual Balancing role?

We note that under current SO incentive arrangements, the maximum daily incentive value is £5,500. Moving to NG's higher reward level would enable NG to earn a potential extra £1.36M a year for essentially the same service to the Shipper community. Therefore, we fail to see what benefits this would bring to Shippers (who fund the incentives) and do not believe the case for change has been made.

NTS Shrinkage & Unaccounted for Gas

Q4. Do you feel it is appropriate to separate the baseline procurement of shrinkage from prompt purchases for changes to forecast levels?

This approach would seem consistent with a typical trading strategy i.e. locking in the bulk of purchases at a long-term fixed price and optimising on or near the day according to changes in demand. However, as above, we would need to see figures to understand the financial impact (or potential savings), rather than just an outline of a concept.

Q5. Do you consider a rolling 9 month price reference period to month ahead of the delivery quarter sets a fair benchmark price for shrinkage energy procurement performance assessment?

No view. Ofgem is best placed to make such an assessment.

Q6. Do you consider the Traded Price of Carbon Adjustment alone provides an appropriate mechanism to incentivise the proper consideration of environmental impacts of compressor use?

No view. Ofgem is best placed to make such an assessment.

Q7. Are there suitable incentives to reduce UAG on all the appropriate industry parties?

This subject is in need of a full, independent perhaps Ofgem-led industry review. Previous SO incentive arrangements appear to have missed the mark in achieving any marked improvements and until the root causes are properly and transparently identified, it seems inappropriate to consider incentives.

Operating Margins (OM)

Q8. Do you agree with our proposal to reconsider OM incentivisation following the OM services review?

Yes, this seems broadly sensible.

Greenhouse Gas Emissions (Venting)

Q9. Do you support our approach for the greenhouse gas emissions incentive and what value would you place on a greenhouse gas emissions scheme?

Given the wider environmental obligations on NG NTS, a reputational incentive would be more suitable in this area.

Timely Connections

Connection Offers

Q10. Do you agree or disagree that we should be incentivised to find new and innovative ways of delivering connection offers quicker than the timescales stated in the UNC?

Given that UNC Mod 373 is not yet implemented (at the time of writing), never mind in operation, we believe it is too early to consider specific incentives in this area. Until we have had projects progress through the new process, we will have no feel for how stretching the targets will be for National Grid. In any case, each project will be different and therefore it will be difficult to read too much into performance statistics without knowing the nature of the connection offer.

We are also concerned that any incentive scheme here may preclude future UNC change if it is imbedded into NG NTS's business; for example, if the incentive scheme would have to be re-opened before a UNC Mod could be approved.

Notwithstanding the above concerns, it seems sensible to encourage NG not to wait until the final day of the deadline before providing a connection 'offer', which tends to be the case in electricity transmission connections. As such, a reputational incentive may suffice in this particular area, until greater experience of the process has been gained by all parties concerned. This could take the form of enhanced information provision (i.e. above Mod 373 minimum Code requirements), but bearing in mind commercial confidentiality.

Capacity Delivery

Q11. Do you agree or disagree that a reputational incentive is appropriate to encourage National Grid to optimise the activities from signature of a bi-lateral contract to capacity application readiness, where applicable?

Yes; although this feels like incentivising NG to do a job it already paid to do (or should be doing) in the best interests of its customers.

Q12. Do you agree or disagree that a financial incentive should be introduced to provide flexibility to adjust obligated lead times where there is a user requirement?

We believe this issue merits further detailed industry consideration to understand the implications.

Constraint Management

Q13. Do you support the principle that SO incentive targets will need to change to reflect the application of the TO uncertainty mechanisms?

We do not support the bundling of exit and entry buy-back costs and do not understand the rationale for change. If the exit buyback arrangements were amended to mirror the entry arrangements, NG would be shifting further risk/costs onto Shippers who are no better placed than NG to deal with them. The proposed scheme also lacks transparency. For instance It is also unclear what “*the inherent risk in the NTS will be used to set a baseline of buybacks*” means in practice or how any party other than NG can appraise the accuracy of the targets that are generated as a result. Overall, we believe the loss of transparency over operation of the network by bundling buy-back incentive schemes would not be in the best interests of Shippers.

Q14. Do you have a view about what the relevant constraint management action price assumed within our modelling?

Defining a single price over a long period is clearly a major challenge and suggests that a single year incentive may be more suitable here to ensure a cost-reflective approach. Clearly prices will be driven by what is happening in the market at the time and how big the constraint is.

Market Facilitation

Demand Forecasting

We remain of the view, as expressed repeatedly through SO Incentive consultation responses that the accuracy of the NDM forecast is very important and we would like to see National Grid looking at the inputs into their forecasts with a view to improving accuracy in this area.

Q15. What aspects of demand forecasting do you use in your decision making and value the most (e.g. forecast times, components of demand etc) and how do you expect your requirements to change over the RIIO-T1 period?

The Day Ahead Forecast is still the most important for us. Unless the gas balancing mechanism changes over the RIIO-T1 period, we would be unlikely to change our view.

Q16. Do you agree or disagree that the absolute forecast error is a more appropriate way to measure forecasting performance than the error as a percentage of demand?

We agree that forecast error removes the benefits from high demand periods, but this change would only be suitable if the targets are selective to temperatures. At the very least, a winter/summer split would be required and perhaps a seasonal split would allow greater targeting. Both mechanisms have benefits/issues and it is important that the measures would drive appropriate improvements.

Q17. Do you agree or disagree that the incentive target should reflect the level of demand volatility in the market?

We do not see it as appropriate that the measure be flexed for demand volatility. This target is aimed at incentivising appropriate market behaviour in the balancing mechanism. Shipper incentives and penalties are not altered to account for demand volatility so we do not see why National Grid should receive particular dispensation.

Information Provision

Q18. Do you agree that it is appropriate to replace the current financial incentive scheme with a reputational incentive?

As noted in our previous SO incentives response, we are conscious that in recent years, an increasingly large amount of Shippers and third parties are accessing NG's website for data, which often feeds into Shipper's operational systems and

processes. A reputational incentive, which requires NG to report on performance, is unlikely to provide Shippers with confidence that the high standards required in terms of availability and timeliness of data publication will be maintained. A re-consideration of incentivisation/penalties in this area should be undertaken by Ofgem, given the recent trend change in the way NG's customers are using its website.

Q19. Are there areas where we could provide more information that would contribute to the efficient operation of the market, bring benefits to stakeholders' businesses and the value they provide to their customers?

We have no immediate concerns, but should the need arise, then the existing UNC governance process allows additional data to be requested and this request to be properly assessed by industry.

Q20. Do you agree with our current approach to review information provision requirements with industry before seeking appropriate funding if necessary?

We support NG undertaking a review of the use of its website by its customers but believe that SO incentive arrangements in this area should not be changed until the review is complete.

Other New Incentives

Maintenance

Q21. Do you agree or disagree that the concept of maintenance days should apply at entry points?

We are a little confused by this proposal since maintenance days already apply at Burton Point, which is an entry point.

Q22. How much notice do you require of maintenance scheduling changes?

The notice required will relate to the nature and extent of the maintenance and the plant affected, however the arrangements may benefit from a minimum notice period (on both sides), subject to the comments below on flexibility.

Q23. Do you support the introduction of a financial incentive scheme relating to the scheduling of maintenance? What value would you place on such an incentive?

We do not believe this issue is necessarily about financial incentives but rather how as customers, we get the flexibility we need, given the commercial nature of our business. For instance, one of the major difficulties facing generators is planned outages for CCGTs, since these outages are determined by running hours which are driven by the prevailing market conditions, so it is difficult to schedule these too far in advance. What Shippers need is the flexibility (and willingness within NG) to change these schedules and the fact that maintenance must be a 7 day a week activity for NG and its contractors.

Capacity Scale back

Q24. Do you agree or disagree that an incentive relating to the restoration of scaled back capacity would maximise the level of non-firm capacity made available to the market?

We do not believe there should be an incentive to restore any scaled back capacity. Surely if the restriction isn't required then the capacity should be offered back to the market. Whilst there currently might not an explicit obligation to do this as quickly as possible, we do not believe it is in the spirit of the Code that it should be artificially held back or held back/released because of a financial incentive. Moreover, if there is such an issue currently existing then we may see Code parties bringing forward UNC proposals to deal with it.

Q25. Do you agree or disagree that linking the financial parameters to buyback cost assumptions is appropriate?

No view. This is a role for Ofgem.

Provision of enhanced services for NTS users

Q26. Do you agree or disagree that an incentive relating to the development of new services such as shorter notice periods or higher ramp rates may be appropriate in future?

Strongly disagree. Industry parties (including NG) are free to bring forward change proposals which can be assessed in accordance with the UNC governance process. The burden of regulatory change is already significant and an incentive which would encourage NG to bring forward a multitude of proposals would be an inappropriate and unhelpful use of NG's resources.

Q27. What are your views on the potential interactions between an incentive and the network flexibility uncertainty mechanism?

We do not support such an incentive and therefore do not believe it merits further consideration.

SO innovation

Q28. Do you agree or disagree that the SO should have access to innovation funding or should it be considered under the TO scheme?

In the absence of evidence to demonstrate the benefits to Shippers; No.