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Dear Sonia

**NGET's rejection of SO incentive scheme 2006/07 final proposals: further views invited**

**Comments**

energywatch welcomes the opportunity to comment on NGET's rejection of the SO incentive scheme 2006/07 final proposals, as outlined in Ofgem's press release R/17.

We share Ofgem's disappointment that NGET has rejected both the options in the final proposals. We note the process going forward, with a reference to the Competition Commission as one possible outcome. We still consider that Ofgem's Option 1 (a target for balancing costs of £390 million, with accompanying sharing factors, cap and collar values) represents an appropriate balance of risk and reward, and provides NGET with a challenging target for energy and system balancing.

In the absence of a SO incentive scheme, and until the process going forward is clearer, we would urge Ofgem, on behalf of consumers, to ensure that NGET's balancing actions are robustly and effectively monitored. If the Authority refers NGET to the Competition Commission, there will be a period during which Ofgem will need to undertake such monitoring in any case. As part of this monitoring process, Ofgem should regularly report to all interested parties on its findings. Transparency regarding market activity should help market participants to take appropriate actions and increase NGET's ability to efficiently manage the system.

There are sound reasons why NGET's rejection of the Ofgem proposals appears questionable:

- NGET has balanced the system during periods of stress and in tight market conditions over this winter. It has done so at a higher cost than perhaps it anticipated. However, there is no rationale for arguing that the experience will be repeated in winter 2006/07. NGET should be learning from the events of the winter and assessing how to balance more efficiently under system stress conditions in preparation for next winter. Consumers expect NGET to deliver an efficiently-run network, sharing the benefits of costs savings with them.
- NGET has indicated that it may make claims for income adjusting events relating to its balancing activity in 2005/06. We hope that any claims will be scrutinised carefully by Ofgem to ensure they relate to exceptional events. If the claims are rejected and, as a result, NGET experiences a loss under the 2005/06 scheme, this is due to its balancing actions. NGET has no right to expect to make a profit from the incentive scheme. Past scheme targets have always been surpassed, indicating that the targets themselves were not challenging enough. An effective scheme needs to stretch NGET's ability to balance in all circumstances and manage the system efficiently.
- The recent Authority decision to approve BSC modification P194 should help NGET to manage and balance the system in a more efficient manner. NGET itself argued that the rationale for P194 is that, under system stress conditions, a more marginal imbalance price would increase market participants' need to self-balance before Gate Closure and thereby reduce the number of balancing actions taken by NGET in the Balancing Mechanism. As the proposed implementation date for P194 is 2 November 2006, the solution will be in place for next winter. It is unreasonable for NGET to argue that, on the one hand, balancing costs will rise under system stress conditions if the events of winter 2005/06 are repeated, while, on the other, it has successfully persuaded the Authority to have a mechanism in place to keep those costs down.

If you do wish to discuss our response further please do not hesitate to contact me on 0191 2212072.

Yours sincerely

Carole Pitkeathley  
Head of Regulatory Affairs