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Our Reference:

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Dear Simon,

NGG SO Incentive on Demand Forecasting and Website Availability

Thank you for the opportunity to respond to this consultation.

It is clear that there have been deficiencies in elements of NGG's operation of the gas system over the winter and that there is the potential for benefits to the market and ultimately customers, to be had. We would fully support any improvements that can be made for this winter. However, we are not convinced that the proposals put forward are necessary, that they are properly targeted, nor that they provide the right balance between cost/risk and reward.

Given NGG already have an allowed revenue to make efficient improvements to their operation, (specifically referred to in the consultation document in relation to improvements that they are making to both Demand forecasting and Website improvements) it is not clear why this income is not already being spent on these "quick wins". It is also unclear why NGG's existing SO incentives e.g. for balancing the system, are not aligned with providing better information to the market and reducing market prices.

Whilst we are receptive to the gaining of quick wins ahead of this winter, we don't believe that we should be moving to micro-regulation to achieve it. NGG have an allowed revenue and a licence obligation to operate an efficient system. If NGG have identified improvements that can be made but feel exposed to the cost of making those improvements, then the simplest solution would be for Ofgem to provide comfort to NGG that their costs will be recoverable through the price control.

Regarding the improvements that are being suggested, it is not clear that NGG have the latitude to significantly influence the errors that can occur in Demand forecasting, such as the weather forecast or DM demand response. Yet, as in any incentive mechanism, it is incumbent that NGG should have influence over these factors if they are to be incentivised on them. In addition, the proposals to average the accuracy over the whole year may be simple, however, this simplicity would be at a significant cost to accuracy. We would suggest that if NGG are to be incentivised on their demand forecasting, that it needs to be at a resolution that

reflects the value to the market, i.e. they should be incentivised on their accuracy on peak days, e.g. the gas equivalent to the Triad demand in electricity. We would also wish to be certain that the already sanctioned IS improvements will not already provide NGG with a benefit under the incentive mechanism.

In our view, NGG's estimated costs of improvements seem high, particularly those for the Website improvements. In addition, we would question the £10.6m cost per day. This would appear to be based on an 8p/th increase in costs over all gas, rather than simply the marginal gas purchased on the day. On a marginal basis, this cost would significantly reduce. If NGG are to be incentivised on their Demand forecasting and Website performance (rather than have their costs recovered through the price control), then both the level of benefit and level of cost of improvement need to be considered, to provide a balance to the incentive. We do not believe that this balance is appropriate in what has been proposed. Notwithstanding our comments above on targeting NGG's incentive on elements they have some influence over, we believe that if an incentive mechanism is to be put in place, that the rewards should be significantly lower than those proposed, and that the incentive should be two-sided. The incentive mechanism should certainly only be in place for this winter.

However, as noted above, we believe that rather than micro regulating NGG's capex spend through the implementation of such an incentive scheme, that these "quick wins" can be achieved by Ofgem simply giving comfort to NGG that such efficient capex spend will be recoverable in the existing price control.

I hope you find our comments helpful. If it would help to discuss any part of our response please do not hesitate to give me a call.

Yours sincerely

Robert Hackland
Regulation Manager