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Dear Sonia,

Potential new System Operator quality of information incentive schemes for National Grid Gas

We welcome the opportunity to comment on the above proposed licence modifications relating to quality of information incentives for National Grid Gas (NGG). This response is on behalf of National Grid Gas in its capacity as the holder of a gas transporter licence in respect of the National Transmission System.

Appropriateness of incentive

Feedback from market participants and Ofgem during and since winter 2005/06 has indicated the growing importance of gas system data to a wider and more active gas market, beyond participants that have direct access to such data through the Gemini system. This wider requirement for data has coincided with significant increases in wholesale market gas prices.

This price effect has also led to increased volatility in gas demand as participants respond to higher, fluctuating prices by increasing demand reduction measures for their consumption of gas. This increased gas demand response on tighter days has presented challenges to the gas demand forecast process and has, as highlighted by Ofgem, led to over-forecast on some tighter days. Ofgem's identification of price sensitivity is supported by our own analysis. This suggests that the main driver of the increase in demand volatility is Daily Metered demand (which is more sensitive to daily fluctuations in price) and that the forecast error of non-Daily Metered demand is low in comparison to that of Daily Metered demand forecast error.

In order to respond to the 'step change' in the needs of the market participants in terms of demand forecast accuracy and information delivery, additional investment is required in systems by National Grid Gas. We agree that an incentive scheme provides the most appropriate framework to stimulate investment by National Grid Gas to deliver performance improvements against such a 'step change' in requirement. Whilst the above identifies clear drivers for the development of incentive arrangements for this year, acceptance of a scheme for winter 2006/07 cannot be taken as acceptance of the need for an enduring scheme. Acceptance of any future scheme framework and/or proposals would be based on its own merits.

The remainder of this letter responds to Ofgem's specific questions on the proposed schemes. Points applying to both schemes are covered first, followed by points referring separately to proposals for demand forecasting and then website performance.

Both schemes - Implementation timescales and duration
We agree that the proposal for scheme implementation in September 2006 for commencement in October 2006 is the best solution (given the tight timetable of delivery for winter 2006/07 to provide certainty of the funding framework to support the required investment. We also agree that the proposed duration of the schemes, at six months, from October 2006 to March 2007, is appropriate. This duration will focus performance incentives on the important winter period and provides a sufficient window for National Grid Gas to deliver performance improvements.

Gas demand forecast accuracy incentive
Scope and performance measure
We consider Ofgem's proposed scope and choice of performance measure for this incentive to be appropriate and measurable.

Scheme parameters
With regard to the scheme parameters, it is important to note that even under a scheme with no downside payment the cost of investment represents a genuine downside risk to NGG. Performance under the proposed demand forecasting incentive is sensitive to the volatility of demand. Should demand volatility increase, for example through more erratic weather or increased demand side response, then forecasting performance may decline despite increased investment by NGG. The proposed scheme does therefore carry a clear risk to NGG in terms of recovery of investment cost.

Website performance incentive
Scope
We consider that the scope of Ofgem's proposed scheme is appropriate given the benchmark data available on NGG's historic website and timeliness performance.

Performance measures
With regard to the performance measures, we consider that the performance measures for timeliness is appropriate and in line with benchmark data provided to Ofgem. However, we have concerns regarding the performance measure for availability proposed within the initial proposals. The use of a very low unavailability benchmark of 4hrs 48mins and a 27% improvement target makes the performance measure very sensitive to a single large loss of availability. For example, a single large information systems failure that took 6 hours to resolve would remove any opportunity to out-performance the incentive.

To address this issue, we would prefer a daily or monthly scheme availability target. This would smooth the effect of a single large event on overall scheme performance, ensuring that an incentive remained on NGG to minimise total website unavailability even following a single large event.

If Ofgem do not consider a daily or monthly scheme appropriate, as a minimum we support a proposal that used the current style of benchmark for availability, but that 'collared' the individual availability and timeliness performance measures. This would remove the risk that poor performance on the availability incentive (e.g. following a single large event) would bring down the average performance across availability and timeliness by so much that it removed any opportunity to outperform on the Timeliness performance measure. This could be achieved by setting a minimum possible level for each of the availability and timeliness performance values within the calculation of the average performance across both measures.

Scheme parameters

With regard to the scheme parameters, as with the demand forecasting accuracy incentive, we would point out that, even under a scheme with no downside payment the cost of investment represents a genuine downside risk to NGG. This downside risk is particularly important to consider given the volatility of the proposed availability performance measure. In addition, performance under the proposed website reliability incentive will be subject to risk posed by potential increases in website loading on tight days. Whilst we accept that events such as tight days remain within the scheme and should be subject to the proposed incentive, we would suggest that it will be necessary to exclude certain force majeur events such as acts of terrorism or specific website attacks such as a denial of service attack where individuals may attempt to deliberately crash a website through the use of high volumes of data requests.

Conclusion

Subject to our points discussed above, we consider that the framework of the proposed incentives has the potential to become a workable scheme that offers reasonable balance of risk and reward. As a result, final scheme proposals built on these proposals would appear to provide a basis on which to fund additional investment to deliver an improvement in performance for this winter in response to the step change in the requirements of market participants.

Within this letter, due to the tight timescales and necessary internal governance processes, we have not offered an opinion as to whether NGG would be inclined to accept Option 1 or 2. We hope to be able to do this in due course, subject to our points contained within this letter.

I would be happy to discuss any of the above in greater detail, with a view to developing proposals that are acceptable to National Grid.

Yours sincerely,

Chris Bennett