energywatch
your gas and electricity watchdog

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Dear Sonia

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

energywatch welcomes the opportunity to respond to the issues raised by this consultation. This response is non-confidential and we are happy for it to be published on the Ofgem website.

We agree that it is critical that the accuracy of demand forecasts are improved, as is the performance of National Grid Gas (NGG)'s website in conveying this information. Consumers, large and small, bore the brunt of the impact of high wholesale prices last winter which fed through to retail prices. The impact on large consumers has resulted, in some cases, in demand destruction and closure of production. For households, particularly those in the vulnerable consumer category, the effect has been to push more towards fuel poverty. We do not believe that these prices were reflective of the ability of gas supply to meet demand in the GB market. We do believe, however, that the lack of good data failed to allow the right price signals to be sent to market participants so that they could provide an appropriate response. Improved timely information flows of more accurate data would increase transparency of market actions and allow both supply and demand to respond to market signals in what may be a very tight gas market during winter 2006/07. We agree with Ofgem that this would be of significant benefit to consumers.

However, we have major concerns, based on the information that Ofgem has provided in the consultation document, about why it needs to bring forward incentives schemes to improve NGG's performance, the motivation behind its preferred type of scheme, and the conclusions to be drawn as a result:

- In paragraph 2.3 of the document, Ofgem states that "The Uniform Network Code (UNC) currently requires NGG to notify forecast daily gas demand levels to market participants for the relevant gas day at both the day ahead stage (D-1) and within-day". This suggests that NGG is already under a code obligation to provide demand forecast data. Presumably, although it is not stated here, the obligation is based on NGG providing the data to a degree of quality and accuracy which is also helpful to users of the data. Yet, in these circumstances, Ofgem still feels the need to go outside the UNC to enforce the obligation on NGG in the form of incentive schemes. This suggests to us that, in fact, the UNC obligation is deficient and that the UNC is not a robust mechanism by which to ensure enforcement of obligations. Ofgem has recently decided to undertake an Industry Codes Compliance Review (ICCR) which may clarify the boundaries of Ofgem's compliance and enforcement powers. We intend to highlight the deficiency in the UNC in our contribution to the ICCR as one example of why the UNC cannot currently be considered robust for the purposes of self-regulation. If consumers cannot rely on robust regulation under the codes, they must look to Ofgem to undertake its wider statutory duty to them and secure effective compliance and enforcement of obligations instead. Ofgem should keep this in mind when pursuing its better regulation agenda. We intend to copy this response to Nick Simpson at Ofgem to highlight this issue under the ICCR.

- We note that Ofgem prefers assymetrical incentive schemes, albeit for the duration of the coming winter only. We do not believe that NGG requires a one-sided incentive to improve both its demand forecasting accuracy and its website performance. We are concerned by Ofgem's reasoning that NGG will only accept upside incentive schemes to ensure timely implementation for winter 2006/07. This seems to us to indicate that NGG is essentially using commercial leverage to obtain the best result for itself from the schemes. NGG is under a licence obligation to operate an efficient and economic network. If improved demand forecasting and website performance help meet this obligation, NGG should actually undertake the obligation without the need for further incentives of any kind. In any case, NGG should be subject to some downside risk to ensure that it will be suitably penalised for failing to meet a minimum level of service provision which will be satisfactory to market participants relying on the data, otherwise the incentives lack teeth. NGG may feel that only upside rewards are needed to allow it to perform. However, consumers, who ultimately pay for these incentives, have a right to expect NGG to perform a code obligation without incentives and, even when the obligation is enforced under the guise of incentive schemes, to perform to the best of its ability to ensure that the significant benefits to consumers which Ofgem identifies are realised. Downside risk must form part of that equation. If Ofgem chooses to proceed with upside only incentive schemes, we demand that Ofgem undertakes a robust review of the schemes as early as possible to ensure that the scope and form of the incentives properly reflect NGG's performance of its obligation.

- We note the analysis which Ofgem has undertaken on NGG's recent forecasting performance. This analysis highlights NGG's deficiency in forecasting as accurately as possible on 'tight' days and its failure to provide updated data on its website to market participants on a timely basis. These are just the kind of signals that users depend upon to respond effectively and help NGG balance the system at economic prices. We agree that the potential financial benefits to consumers arise through improved response to more accurate forecasts and more efficient balancing by NGG as the System Operator (SO). The analysis underlines why we feel that upside only incentives unduly favour NGG since it was already under an obligation to perform better during the period covered by the analysis.

We have the following comments on the scope, form and duration of the proposed incentive schemes:

- scope – we agree that the first forecast of demand (day ahead before 14:00) sets the tone for subsequent forecasts and should be used as the benchmark for improving accuracy. NGG must, in any case, be looking to provide demand data as accurately as possible, as early as possible, to the market. We would like to see NGG produce demand forecasts as early as D-5, with the accuracy of these forecasts monitored initially to determine whether they provide effective market signals. We note that difficulties, such as uncertainties due to weather, impact on accuracy of this forecast. Likewise, more disaggregated demand forecast data should also help develop efficient price signals. We agree that, initially, simple and transparent measures can be useful in gauging NGG's performance. We also agree that timely availability of data on the website in the most important data fields to users should set the benchmark for the website performance incentive.

- form – as previously stated, we do not believe asymmetric incentive schemes are helpful. NGG's performance ought to improve this winter in any case compared to last if it has taken on board the lessons of deficiencies in its demand forecasting and website performance during winter 2005/06. We note that NGG is planning to invest in systems and processes which should improve forecasting. The proposed incentives will allow recovery beyond the costs of these changes. We would like to see rigorous scrutiny of NGG's actions this winter to ensure that it is delivering benefits under the incentive schemes and the setting of testing targets to be achieved before rewards are provided. We would, therefore, favour Option 2 under both incentive schemes because they include a downside element if NGG fails to meet benchmark performance. However, we also note that upside payments increase under Option 2 schemes compared to the 'upside only' Option 1 schemes. We question whether there should not be a better balance to the incentives under the schemes.

- duration – we agree that the coming winter period is a suitable duration for the schemes. We would urge Ofgem to revisit the schemes as early as possible if it chooses to implement Option 1 (the 'upside only' schemes) so that any enduring schemes are much more balanced in terms of risk and reward.

Going forward, we will continue to keep these issues under review as and when they are raised, always considering the possible impact on consumers.

We would appreciate being kept informed of the progress of the consultation and any related issues to enable us to comment as the need arises.

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