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Dear Sonia

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

EDF Energy welcomes this opportunity to comment on your consultation on introducing quality of information incentives schemes for NG Gas on their demand forecasts and website performance.

We agree that NGG should improve the quality and timing of its information generally but we do not understand why NG should be incentivised to do this as it should already be a key obligation under their licence to constantly improve their service as monopoly Gas Transporter of the NTS. However, we generally believe that incentives on NGG to improve the quality of its information could deliver industry benefits, especially in the case of improved demand forecasts, but we have concerns about Ofgem's proposed methodology in that some system users will benefit more than others. We stress the importance of proper cost allocation in order for these incentives to work effectively and efficiently.

In terms of Ofgem's analysis we welcome the level of detail and work undertaken to support their proposals. However, we believe an assessment of their performance over the last 5 years would have produced a better picture in order to set incentive targets. We also believe that incentives should span more than 6 months so that benefits are accrued and improvements are maintained from one year to another. Improvements in demand forecasting should also apply to sub-components such as NDM forecasts to ensure that customer's interests are being protected.

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We have answered the questions in the consultation in the order they were presented and hope that you find our comments useful – see appendix 1. Please contact me on the number below should you wish to discuss our response further.

Yours sincerely

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Appendix 1

Question 3.1: Do you agree that the scope of potential benefits from improved quality of information is correct?

We agree with Ofgem's view and analysis that shows that an improvement in the quality and level of information release will lead to potential benefits in terms of more efficient market pricing and better informed trading decisions. However, it is not clear on how much NGG's performance will improve, especially in relation to their demand forecasts as they depend now on information from many sources over which they have little control on the quality of data. For example, it has been noted that NGG's forecast of Non-daily metered (NDM) demand has deteriorated since NG sold four of its distribution businesses as the quality of information and forecasts received from the DNs deteriorated significantly. However, it is hoped that incentives on NGG as the primary system balancer and forecaster will help resolve these issues with their data sources.

Question 3.2: Do you agree that the potential benefits from improvements in demand forecasting accuracy are quantified appropriately?

We agree with Ofgem's analysis of the costs by comparing changes in the level of forecast demand with associated cost of supplies from the supply stack. We agree that the benefits of better forecasting will be seen in lower price volatility from day to day and intra day. On this basis, we believe more analysis could be done to compare the accuracy of demand forecasts within day and up to the final allocation on D+5 in order to identify the accuracy of these fluctuations as these can have quite a dramatic affect on prices. If the benefits of these incentives are to be had then they must be applied to all of NGG's demand forecasts, not just the D-1 to the D+5, as many of costs are produced from buying and selling gas within day to match end of day expectations. However, we are unsure as to how one could accurately track and assess all demand forecasts given the myriad of demand drivers.

Question 3.3: Do you agree that the potential benefits from improvements in website performance are quantified appropriately?

We are sceptical as to whether this incentive is actually needed as it involves a huge amount of investment (£600k) for a relative small amount of improvement as Ofgem's analysis suggests that systems are available almost 99.9% of the time. It is not clear from Ofgem's document exactly what this £600k includes but we question whether the ratio of investment to benefit makes this incentive

sensible or even necessary. It is not clear from Ofgem's analysis what the industry costs are resulting from this 0.11% downtime. We believe NGG should be incentivised to use its current systems and procedures for ensuring the website is maintained on line as much as possible as they do currently.

Question 4.1: Do you agree with the choice of performance measure for the gas demand forecasting accuracy and website performance incentives?

In relation to the demand forecasting incentive it is not clear from Ofgem's document which end figure is being used to measure NGG D+1 14:00 forecast, although we understand that it is the D+5 figure that is being used from a recent DSWG meeting.[1] We agree that this is a useful point of measurement but we also believe that Ofgem should be looking at improving the performance of their intra-day demand forecasts and how volatile they are, to ascertain if they are related to weather or storage injections or something else. We also believe that NGG's incentive should be pegged against not just total system demand but sub-components of system demand such as both LDZ throughput and NDM demand attributions which they are solely responsible for and which many suppliers follow as they are cashout to this figure. This would also ensure that customers interests are being protect as NGG would be incentivised to produce as accurate figure at the end of the gas day compared to their D+5allocation so that suppliers, and customers do not face unnecessary financial exposure.

Question 4.2: Do you agree with the proposed scope of both of the proposed incentives?

In relation to the demand forecasting incentive we believe these should be symmetrical to have any benefit for end-users of this information, otherwise this whole incentive scheme could have the risk of just creating extra cost and risk to the industry. For example, NGG could make the necessary investment, which Ofgem has stated could cost £200k to £400k without any improvement over and above this. We therefore support option 2 as the better incentive.

We believe that the initial steep slope of the incentive to reflect any improvements is too sharp as this will mean any small improvement by NGG will automatically trigger a significant proportion of the reward. We understand that this is so that NGG cover their implementation costs but even so we believe these go over and above covering costs and should be shallower. For example,

[1] Demand Side Working Group meeting 21st June 2006 established the D-1 14:00 figure was being compared to the D+5 final allocation figure.

for a 5% improvement under option 1, NGG will earn £800k straight away, even though NGG's costs of implementing systems which will improve their demand forecast performance is in the order of £200k to £400k. We believe the 5% should hit the line at the £400k mark which is still a generous incentive to produce the desired outcome of covering implementation costs.

We believe the steepness of the beginning of the line is also an issue under the website incentive due to the relative ease with which they can improve on their performance from investing £600k and earn £1m. Indeed, according to paragraph 4.58 NGG recognise where it can make the improvements straight away and we question why then is an incentive even necessary.

Question 4.3: Do you agree that the incentives should not be weighted towards any specific period within the duration of the incentive?

We believe that the incentives should be weighted towards the winter months as this is the period when quality information counts the most because of the high costs of balancing in these tight months. NGG's performance in the months from October to March are therefore paramount in ensuring that industry's costs are kept to a minimum through excellent information release. It has been shown that industry use of NGG's website halved after the winter reflecting the level of importance in post winter months. One way of doing this would be to profile the incentive such that NGG could gain, or loose 75% of their yearly incentive in the months October to March, the remaining 25% being left for the months April to September.

Question 4.4: Do you consider posting of key data within 20 minutes of real time to be an appropriate measure of timeliness to use in the website performance measure?

It is not clear from Ofgem's analysis how the timeliness of NGGs publications is being measured. For example, although NGG publishes demand forecasts every hour, they never arrive on the hour, but between 5 and 20 minutes after the hour. Therefore, it is not clear whether this is the best time that NGG can realistically publish this information or whether NGG needs to be pegged against on the hour publication. However, we believe that this is irrelevant so long as all market participants are receiving the data all at the same time, but it appears the website is significantly slower at publishing data than the Gemini system. We would therefore agree that the maximum allowance for website publication should be 15 – 20 minutes to align it with the Gemini information release.

Question 4.5: Do you consider Option 1 or Option 2 of the demand forecasting accuracy incentive to be most appropriate?

We believe only Option 2 could be realistically implemented to have symmetrical incentives to ensure that NGG share in minimising the risks.

Question 4.6: Do you consider Option 1 or Option 2 of the website performance incentive to be most appropriate?

For the same reasons above, we prefer Option 2 of the incentives to ensure that NGG shares some of the risk in not getting information to end-users quickly enough.

Question 4.7: Do you agree with the proposed duration of the incentives?

We do not believe that a 6 month incentive over the winter will derive the necessary benefits either in the first or subsequent years as there is no enduring incentive for NGG to keep up the improvement in performance. For example, NGG may choose to only slightly improve their performance in a 6 month incentive for fear that they their target will be tightened if they over perform, as they would be expected to perform to that level every year. We believe a better and more robust incentive would be to have it last several years such that NGG could be rewarded for improving year on year. We suggest a 2 or 3 year incentive where any improvement in year 1 would have to be matched or improved in year 2 for NGG to receive the full year 1 reward at the end of year 2. For example, if NGG gained £2m of their incentive in year 1 then they would have to match it better it in year 2 in order to receive the full £2m from year one or the £2m would be reduced by the amount they under performed. Naturally, any mitigating circumstances would be taken into account by Ofgem but this model would ensure that NGG maintained the same level of incentive across the years.

Question 4.8: Do you agree with the proposed method of recovering any resulting cost from these incentive schemes?

We believe that costs should be targeted at those causing them or at those that benefit from cost improvement. In this case, it is not clear that broadly smearing these costs amongst all system users relative to their throughput through SO Commodity costs is the most appropriate. For example, Ofgem has stated in their document that it has been large end-users who have complained and who have lost the most from the inefficiencies identified. Yet some of these parties might never face a smear of the costs as some transportation costs are not

passed through to customers by suppliers/shippers. We suggest therefore that the majority of these costs are targeted at these large end-users who stand to capitalise significantly from these improvements. Ofgem could target these end-users via the definition of large Daily Metered customers via the definition in the UNC. We believe this would be a more efficient and fair way to target these incentive costs across the industry.