



June 23, 2006

**Ofgem consultation – Potential new System Operator quality of information
incentive schemes for National Grid Gas
Comments from the Association of Electricity Producers**

The Association of Electricity Producers (AEP) is the UK trade association representing electricity generators. It has some 90 members ranging from small firms to large, well-known PLCs. Between them they represent at least 90 per cent of the transmission connected generating capacity and they embrace nearly every generating technology used in the UK. Many member companies have interests in the production and development of renewable energy where the government has set ambitious targets for development over the next decades

The Association welcomes the opportunity to provide comments on this consultation; we consider the availability of accurate timely information is a key factor in efficient market operation. However we also recognise the importance of incentives being designed to ensure the anticipated benefits are delivered.

We provide comments below to the questions posed in the consultation document.

Qn3.1 Do you agree that the scope of potential benefits from improved quality of information is correct?

The Association broadly agrees with the scope of potential benefits, clearly market efficiency is compromised if decisions are taken on the basis of outdated or inaccurate information. It is also important that all participants have access to the same information at the same time to avoid distortions.

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

The quantification of benefits is always difficult and assumptions need to be made. In this case the methodology seems reasonable. The £10.6 M cost per day quoted as an upper limit assumes that the price of all gas is 8p/th higher than would have been the case if the demand forecast had been more accurate. As more contracts are now indexed to prompt prices than in the past this is reasonable. It could even be argued that the effect is larger as the effect may affect prices for more than one day.

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

As above we acknowledge that quantifying benefits is challenging and assumptions need to be made. Therefore the approach seems reasonable.

Qn 4.1 Do you agree with the choice of performance measures for the gas demand forecasting accuracy and website performance incentives?

We agree that an accurate forecast of total system demand is likely to be the most useful to participants. However it is generally more appropriate to measure performance against a parameter that the party being monitored has some influence over or expertise in. As total system demand includes NTS connected demand as a simple addition to aggregate DN demand it is not clear that total system demand is the best performance measure. NTS connected demand could change its nominations at any time for reasons beyond National Grid's (NG) knowledge or expertise and yet this could cause NG to fail to meet its incentive target through no fault of its own.

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

We broadly agree with the proposed scope see other comments to other questions for more detailed views.

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

We acknowledge that weighting the incentive equally through the period provides for greater simplicity and transparency yet we are surprised that DSWG representatives favoured this. We would have expected that more accurate demand forecasts and more timely website updates were of greater value when the system was stressed and prices were most sensitive to forecast demand. In the absence of any weightings improvements might be seen during the months when this is easy to achieve and perhaps no improvement over the more critical months such that on average NG exceeds the performance measure and receives incentive revenue yet the benefits to the industry are limited. We suggest that analysis is undertaken this coming winter of any improvements in performance to explore if these are achieved uniformly throughout the period. Such information could inform future incentive development.

Qn 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?

Given the current performance detailed in Chapter 2 - 20 minutes of real-time would seem to be a reasonable starting point for this performance measure, although in time we would expect this to reduce significantly.

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

In general we would consider that two sided incentives provide for a better balance of risk and reward between NG, the industry and consumers. We do not consider this should be compromised in order to ensure an incentive is in place for this winter. NG appears to have already considered improvements it could make for a relatively modest cost to improve performance this winter. Therefore we see no reason why it should not accept a two sided incentive. In addition it appears that there is already IS work sanctioned, and therefore funded, that may improve performance without any further expenditure. Although we accept that the scope of this work is not detailed in the consultation document.

If the currently funded work is expected to deliver improvements in performance against these performance measures then the target should be adjusted accordingly otherwise consumers may end up paying twice for any marginal improvement, once through allowed revenue and again via any incentive payments. In the absence of any further information on this we can therefore only recommend a two-sided incentive but with the upside potential limited to that of option 1.

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

Please see comments under Qn 4.5. We have similar concerns regarding two sided incentives and currently sanctioned IS work.

Qn 4.7 Do you agree with the proposed duration of the incentives?

We agree that in the first instance these incentives should run just for this winter period, lessons learnt may then inform future incentive development.

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

We agree that it is appropriate to recover any costs via the SO commodity charge