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Your Ref: Ofgem doc 122/06

Dear Sonia

**Potential new System Operator quality of information incentive schemes for National Grid Gas: Final proposals and statutory licence consultation**

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

As we noted in our response on Ofgem's initial proposals, we believe that the lack of good quality demand forecast data and its timely provision had a significant effect on wholesale gas prices last winter. With predictions of a further 'tight' gas supply this coming winter, there needs to be a real improvement by National Grid Gas (NGG) in both areas. Consumers, particularly the most vulnerable, continue to pay a heavy price for these increased costs. With improved transparency, accuracy and timeliness of data, it is hoped that market participants will make more rational decisions about supply and demand which will be reflected in gas prices and thereby ultimately improve the position for consumers.

We remain disappointed that Ofgem feels that NGG requires additional financial incentives to achieve what is effectively an existing licence obligation, namely the operation of the NTS in an efficient, economic and coordinated manner. Providing accurate demand forecast data in a timely manner is, in our view, part and parcel of that obligation. We remain unhappy with the concept of the information incentive schemes and we note that Ofgem at least recognises that an early review of these schemes is necessary alongside the other SO incentive schemes to which NGG is subject. Appropriate and comprehensive SO incentives which create effective and realistic targets should assist in ensuring that NGG is meeting its obligations.

As our comments above suggest, we do not agree with these schemes in principle. We are also unhappy with the final proposals as set out. The reasons are clear:

- Ofgem has conceded that there should be a downside risk for NGG in respect of the demand forecasting accuracy incentive. However, this does not detract from the fact that NGG is provided with a proportionately significant cash incentive for a relatively minor improvement to the accuracy of the forecast, namely £1.6 million for a 5% improvement on the target error. In addition, while there is a

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cap on the incentive, set at £9.2 million, we are concerned that Ofgem has conceded this high level of payment for a 100% improvement because NGG would not accept the downside risk otherwise. The initial slope of the incentive seems to be weighted heavily in favour of NGG and NGG appears to be using the possibility of tight gas supplies as a lever to obtain increased payments. We feel this is contrary to the interests of consumers who are already paying a significant price. We disagree with Ofgem's view, stated in paragraph 3.6 of the document, that "…this form of incentive represents a more equal allocation of risk between NGG and customers and is appropriate for this winter."

- In respect of the website performance incentive, we note that there is no downside risk at all, and that the initial slope again seems to provide a proportionately significant benefit (£1 million for 27% improved performance) to NGG when the cap on the incentive for 100% improvement is set at £1.5 million. Again, Ofgem appears to have taken an unduly narrow view that NGG ought to be rewarded in this way for this particular winter. It seems to us that there has been a great deal of warning for some time about the potential for a tight gas supply this coming winter and that NGG amongst others should already be taking preparatory action which seeks to mitigate the impact on prices in line with existing licence obligations rather than relying on further incentives of the kind proposed to deal with the situation.

Notwithstanding our views above, we agree that the duration of the incentive schemes should be limited to the period 1 October 2006 to 1 April 2007. However, we reiterate the view that these schemes ought to be unnecessary in the first place.

We have considered the draft legal text to be inserted into NGG's gas transporter licence to reflect the introduction of the incentive schemes and agree that this is fit for purpose.

Going forward, we will continue to keep these issues under review as and when they are raised, always considering the possible impact on consumers. In particular, we will take a keen interest in the review of these incentives when Ofgem chooses to undertake that exercise.

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