



Ian Marlee
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Dear Ian

National Grid Gas (NGG) SO Incentives for 1 April 2010 – Ofgem Final Proposals

EDF Energy welcomes the opportunity to respond to Ofgem's consultation on their final recommendations for NGG's SO Incentive proposals for April 2010 to March 2011. We have engaged with NGG all along this process and believe it was well managed by NGG.

We welcome the constructive arguments provided by Ofgem to support their recommendations, however we note that these do not always reflect the majority of respondent's views following NGG's Initial Recommendation consultation in December. However, we are disappointed that Ofgem's proposals to place Licence Conditions on NGG to develop (and implement if appropriate) Linepack Trading and default cashout proposals by April 2011 have not been discussed in detail during this process. These proposals represent two areas of major reform which could significantly change the commercial market dynamics. We would wish to see appropriate regulation processes used and a full assessment of the possible impacts these might have should this incentive be accepted by NGG.

We generally believe NGG incentives have been improved and tightened over the years now to a level where they are incentivising an expected level of efficient behaviour by the SO. So much so that one could question where NGG needs to be further incentivised to maintain this performance or whether it should be part of their overall duties as a Gas Transporter to operate as efficiently as possible. Indeed, in the instance of their Data Publication incentive we believe NGG should no longer be incentivised and be paid to maintain a website which could be considered a basic service to its customers. To this extent we welcome and support Ofgem's suggestion that it should be considered as part of NGG's price control revenue. In terms of the length of incentives we agree with the extension of some incentives from one to two years to allow NGG time to invest to improve their performance where necessary.

We have responded specifically to Ofgem's two questions in the appendix attached and hope you find our comments useful however please contact my colleague John Costa (john.costa@edfenergy.com , 0203 126 2324) if you wish to discuss this response further.

Yours sincerely

A handwritten signature in blue ink, appearing to read "Seb Eyre".

Dr. Sebastian Eyre
Energy Regulation, Energy Sourcing & Customer Supply

Question 1: Do you consider that the final proposals for the SO incentive schemes to apply to NGG's external SO costs represent a fair balance of risk and reward?

We generally agree with Ofgem's proposals and believe Ofgem strives to achieve the best balance of risk and reward for the System Operator. It is difficult to say whether the right balance has been achieved however we have a number of concerns where the balance is not as right as it could be. In terms of the Information Publication we believe that this could and should be removed, as stated in the last few years, now that NGG has set up and been remunerated for the upgrade of its website. NGG does not need an incentive for good performance as this information should be automatically available and adequately maintained for Shippers and suppliers as their customers. Continuing to incentivise the SO for something they should be doing automatically as a supplier of services is unreasonable and distorts the level of risk /reward between market players and could be considered a free incentive. However we welcome Ofgem's proposal to make this part of NGG's price control revenue.

We support the use of scheme adjusters within an incentivised period to account for events or cost outside of the SO's control as these ensure the SO remains incentivised for a longer period. However we feel that allowing NGG to change its incentive target mid-way through the incentive year creating a retrospective change is inappropriate. Ofgem has opposed retrospective changes in the past as they may allow either a windfall benefit or tax and whilst we welcome NGG's admittance of their error, we don't see why this position should be changed in respect of an SO. We note these actions are inconsistent and do not reflect a satisfactory balance of risk reward between different industry participants.

Do you consider that the proposed licence modifications appropriately reflect the final proposals as described in this chapter?

We do not believe Licence conditions are warranted at this stage. Firstly, Ofgem has recommended not changing NGG's Linepack measure (LPM) despite acknowledging the measure was promoting the wrong behaviour by incentivising NGG to enter the market unnecessarily and despite the support for changes from most respondents. Instead Ofgem has decided to introduce Licence Conditions (LC) on NGG to develop proposals by April 2011 to resolve the issue. We believe they are separate issues and it still needs to be discussed and agreed whether replacing NGG's LPM incentive with a Linepack Product is necessary or the right thing to do.

Changing the Price Performance Measure (PPM) does not change the LPM and we question why an obligation through a LC to introduce a Linepack product is needed when Ofgem considers the current LPM does not need changing.

As we have discussed above we would have welcomed earlier opportunity to discuss the Licence condition for development of a Linepack product and cash-out mechanisms. Indeed, it would have been beneficial to have discussed and developed these suggested changes prior to raising them as Licence Conditions. It is disappointing that this solution of issuing Linepack product was not discussed in any great detail earlier in this process. We believe that this would have represented a better use of the Governance arrangements. It is imperative that introducing Licence Conditions in this way does not reduce the ability of the industry to identify the most cost effective solution. It could be considered that these proposals introduce regulatory risk when the potential commercial consequences are taken into account. We believe this topic should and could have been introduced as

Transmission workstream topic; as a Review Modification but ultimately as part of SO Incentives year long consultation.

It would have been helpful if Ofgem had highlighted these potential developments at the “initial recommendations” stage to aid industry debate.

Should NGG accept these licence conditions we hope that appropriate mechanisms will be used to debate and assess any proposals. We note that appropriate governance procedures provide a valuable opportunity for industry participants to provide comments in a clearly constructed procedure and would expect them to be followed as good practice. We are concerned that the introduction of these licence conditions on such significant topics might result in inappropriate outcomes and would welcome more detail on the mechanisms NGG should employ in discharging these conditions.