



**National Grid Gas NTS System Operator Incentives from 1<sup>st</sup> April 2010  
Ofgem Final Proposals Consultation  
AEP<sup>1</sup> Comments**

The Association welcomes the opportunity to comment on this final proposals consultation, and has been an active participant in the National Grid led process throughout the year.

We consider the process has worked well with a good level of engagement of the industry and an open consultation process. We also welcome an improvement in transparency in Ofgem's thinking by its issuing an open letter providing initial comments in November 09. However we are concerned with the apparent disconnect between Ofgem's initial comments and final proposals, particularly in relation to the residual balancing incentive. This again leaves the industry with little knowledge of the incentive framework to be in place from April 2010 until just prior to that date. This leads us to question the merits of the National Grid led process, but, without suggesting fault on the part of National Grid.

Residual Balancing

With respect to the residual balancing incentive Ofgem has proposed a staged reduction in the price performance measure (PPM) target, with no changes to the linepack incentive, whilst it was the latter that had been the focus of attention and had some support for change from the industry during the consultation process. So far as we are aware there was no discussion of changes to the PPM during the year. We consider that Ofgem should have flagged its intentions in this respect during the year. It seems that Ofgem considers tightening the PPM will act as an incentive on National Grid to develop a gas linepack product (para 2.22). We consider this to be a wholly inappropriate use of the SO incentive framework.

We do accept that Ofgem flagged that it would like to see a linepack product developed in its Final Proposals Consultation in Feb 09 and acknowledge that it has not been progressed as a priority by National Grid since there was little interest in the product. However if the industry or National Grid saw merits in such a concept then a modification proposal could have been raised. The absence of such a proposal

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<sup>1</sup>The Association of Electricity Producers (AEP) represents large, medium and small companies accounting for more than 95 per cent of the UK generating capacity, together with a number of businesses that provide equipment and services to the generating industry. Between them, the members embrace all of the generating technologies used commercially in the UK, from coal, gas and nuclear power, to a wide range of renewable energies.

indicates there is little value in this. However Ofgem seems determined to press ahead with its own agenda and is proposing inserting a licence condition requiring National Grid to use reasonable endeavours to develop such a product by April 11 for implementation by October 11 if directed. Such intervention in the arrangements seems at odds with better regulation principles and a totally disproportionate response to an issue that is not well defined and lacking any clear objectives. This also means that Ofgem would effectively be raising a modification proposal that it would subsequently be making judgement on - a principle that we oppose. Notwithstanding these comments the implementation timescale seems very short given that changes to National Grid and shipper systems will be necessary and we would also like to seek assurances that an Impact assessment will be undertaken.

#### Demand Forecasting

We consider it appropriate for the incentives to be tightened and to focus on the D-1 forecast, but it is disappointing the seasonal targets are not being introduced.

#### Environmental Incentives

The Association is aware that National Grid has been undertaking a review of the methodologies for calculating vented volumes and supports such initiatives to improve accuracy of calculated volumes. In paragraph 2.56 it seems that the new methodology *'has resulted in increases in the calculated volumes for the same level of performance'*. We do not really understand what this means, other than perhaps operational decisions were not affected ?

Further in para 2.67 it says the target for 2010 was to be set at 1508 tonnes of natural gas but because of the new methodology it will be set at 3007 tonnes, almost double. Whilst further transparency of National Grid's Methane Initiative may not be appropriate we seek assurances from Ofgem that it has satisfied itself that the project and its outcome are robust given the doubling of the target and the environmental impact of this.

Looking forward we consider that any further incentives with regard to emissions which require significant capital expenditure would be better considered as part of the Price Control rather than SO incentives. However it would be important to ensure consistency of approach with other environmental incentives and legislation to avoid double counting. Of particular concern is where National Grid considers it may have incentives to release natural gas rather than combust it.

#### OM Contestability

The Association supports Ofgem's proposals in this area and acknowledges that the design of an appropriate incentive is challenging given the range of service providers and varying cost structures.

The Association considers that broadly the incentives represent a reasonable balance of risk and reward, whilst being fairly challenging in some areas.

The Association has not reviewed the detailed licence drafting and therefore is unable to comment as to whether it accurately reflects the final proposals.

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