System Operator Incentive Schemes from 2013
AEP[1] Comments

CHAPTER: One
Question 1: Do you consider that the general principles we have used are appropriate? Are there any other principles that we need to consider?

The Association broadly agrees with the general principles described and particularly recognising the interaction between TO and SO activities. We also recognise there may be benefits in longer term incentives encouraging actions with a longer term payback but this will need to be considered against opportunities to tune parameters where initial targets are proving to be 'too easy' or 'too challenging'. We very much agree that transparency will be a key issue in the operation of any incentives to ensure stakeholders have confidence in the arrangements. Ultimately the key issue is the provision of cost effective system operation for the benefit of the industry and customers overall.

CHAPTER: Three
Question 2: Do you consider that we have identified all the relevant outputs for the electricity SO? Should we consider any other outputs?

Question 3: Do you consider that we have identified all the relevant outputs for the gas SO? Should we consider any other outputs?

We consider that a broad range of outputs covering NGG activities has been identified. We would also support an incentive relating to maintenance scheduling since short notice changes to NGG schedules can be very costly for gas fired generators. Any such incentive would need careful design to avoid losing all flexibility in maintenance scheduling when it can be accommodated or is beneficial to both parties. Consideration to minimising the impact on gas fired generation operations including off peak / weekend working would also be beneficial to station operators and ultimately customers in general.

---

[1]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.

Question 4: Please provide your views on which of the outputs of both the electricity and gas SOs should be incentivised.

For gas, financial incentives are most appropriate when there is a cost to industry and ultimately customers arising from NGG's system operation decisions. Such costs may be direct in the case of shrinkage or less direct as in the case of the price performance measure as part of the residual balancing incentive. Here the impact of NGG's action can influence the wholesale price of gas so the consequences stretch far wider than simply balancing costs. In such circumstances the cost of any incentive payments to NGG are worthwhile since through sharing factors the cost reduction to customers is a larger amount.

Question 5: Do you agree that it may be more appropriate to place licence obligations (funded through the internal gas SO incentive scheme) with respect to UAG and /or Information Provision?

We recognise the improvements made in information provision and note that the incentive payments are small so it may be appropriate to secure the levels of service for information provision through a licence condition so long as monitoring of service delivery is maintained.

As regards UAG we are not entirely clear how an incentive that incentivises the cost of procuring UAG alongside other shrinkage elements would work in practice when the volume may not be incentivised. We recognise that UAG is a complex issue and that in principle incentives should only be placed on parties that can influence the outcome, whilst it is debateable whether NGG can influence the UAG position it is clear they are best placed to investigate the root causes further. We note that as recently as 2003/4 the net position across the year was negative but that volumes have grown since then.

Question 6: Is there a need for greater incentivisation of NGET and NGG with respect to customer satisfaction? If yes, what form should this incentivisation take?

There are a number of areas where customers, (whether they are generators, developers shippers or end users) are unhappy with services provided by NG, connections and maintenance planning are two that come to mind. Clearly improvements in these areas would be welcomed by the affected parties However its not entirely apparent how customer service can be readily defined in a robust manner and linked to incentive revenues. As noted in the document customer satisfaction surveys could be biased. However we think there is merit in pursuing some frameworks in this area but it would be important to ensure that if surveys are undertaken they are targeted to the appropriate interested parties, which have direct interaction with NG and are affected by its actions.

CHAPTER: Four

Question 7: Do you consider that the reasons we have proposed for bundling are reasonable? If not, please provide your views as to why.

The reasons provided seem sensible, and may deliver benefits where there are clear interactions but this is not self evident.

Question 8: Do you consider that the options for bundling are reasonable? Are there any additional options that we should be considering?

We consider the options presented are reasonable in principle but how they would be applied in practice is important. A greater appreciation of the likely interactions is needed before we can provide a view on this.

Question 9: Do you consider that, based on the current outputs that are incentivised, continuing to bundle the electricity SO scheme is appropriate?

Question 10: If you consider that the electricity SO should be incentivised on additional outputs, should these be part of the same bundled scheme? If not, how should the incentives be packaged?

Question 11: Do you consider that there is merit in increasing the number of gas outputs incentivised through a single scheme?

There may be merit in bundling some of the incentive schemes where there may be synergies or interactions in the decision making processes within NG that could affect more than one scheme. A concern would be loss of transparency and whether overall the new scheme would delivery better 'value' and more efficient system operation to the industry and ultimately to customers.

Question 12: How do you consider the outputs of the gas SO should be incentivised?

The traditional target with sharing factors and caps and collars has worked well to date and is well understood. However where incentive schemes are combined the combined target should be less than the sum of the component parts to demonstrate that benefits to the industry and customers as expected to accrue from combining incentive schemes. There should also be caution of combining incentives where the combined scheme may be dominated by one element shrinkage for example, even if UAG were considered separately.

Question 13: How do you consider that the incentives on the gas SO should be packaged?

Only incentive elements where there are potential interactions should be considered for inclusion in a package, the wider consequences should also be considered. There may be scope for combining incentives such that operational 'must do' activities are included such as shrinkage, emissions and OM but perhaps the residual balancing and operational buyback should be considered separately given the potential wider impact on the wholesale market of NG's decisions and the greater discretion it has in this area.

CHAPTER: Five

Question 14: Have all the benefits associated with moving to longer term incentive schemes been captured? Should any additional issues be considered?

We consider Ofgem has presented a good description of the potential benefits of longer term incentive schemes and some of the risks. However a balance needs to be struck between placing incentives on NG to undertake actions that it should be taking as a matter of course as an efficient system operator.

Question 15: Can longer term SO schemes be implemented through the different approaches discussed, year by year incentives and multi year block incentives? What do you consider are the relative merits (or otherwise) of each approach?

We consider that multi-year block incentives provide greater incentive for initiatives which pay back over a longer time period than year by year incentives but they do face the risk of caps and collars being hit and the incentive losing its effectiveness. We note that NGG has generally performed well under the existing incentives routinely being revenue positive overall.

Question 16: Is our proposed treatment of uncertainty and risk associated with longer term schemes reasonable? If not, please explain how this can be improved.

We agree that uncertainty mechanisms would seem to be a necessary feature of longer term incentives, particularly as a move to an eight year scheme with some bundling would be a significant change from the current two year schemes for gas.

We note Ofgem has made a number of suggestions but we are not clear exactly what it is proposing for dealing with uncertainty.

CHAPTER: Six

Question 17: Do you consider that it would be of overall benefit to consumers to better align the incentives of the SOs and the TOs?

Yes a more joined up approach could be beneficial, its not too long ago that the gas TO and SO activities were under one price control.

Question 18: Please provide your views on the extent to which better alignment can be achieved through the alignment of the incentive schemes under the same and separate ownership.

Question 19: Please provide your views on the economic incentives to drive SO-TO interactions ("payment mechanism"). In what areas could this principle be usefully applied?

In principle this mechanism may deliver an improved level of service over and above the agreed baseline, but we would like to see more details of how this would work in practice and the level of transparency of decision making that would be appropriate. Assurances that effective interactions can be achieved would be helpful to give the industry confidence in the arrangements.

26 July 2011

Association of Electricity Producers
Charles House
5-11 Regent Street
London
SW1Y 4LR
Tel: 020 7930 9390
Fax: 020 7930 9391
Email: jcox@aepuk.com
www.aepuk.com