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System Operators, Transmission
and Transportation System
Owners, Generators, Shippers,
Suppliers, Customers and Other
Interested Parties

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Date: 1 February 2012

Dear Colleague,

National Grid Gas System Operator incentives from 1 April 2012

On 14 December 2011, Ofgem published its Final Proposals Consultation Letter in respect of National Grid Gas (NGG) System Operator (SO) incentive schemes to apply from 1 April 2012¹. The consultation letter set out our final proposals for the five incentive schemes expiring on 31 March 2012. This consultation closed on 18 January 2012 and we received responses from NGG and one other industry participant. In this letter we set out our intention, following consideration of these responses, to direct changes to NGG's transporter licence to implement in full our final proposals.

The responses to our final proposals consultation raised issues for our consideration in respect to our proposals on Unaccounted for Gas (UAG)², data publication and demand forecasting, which we address below.

On UAG, one respondent suggested that they considered levels of UAG on the NTS unacceptable and that our proposals required NGG to do little other than what they do under the status quo. The respondent also suggested that we concentrate on finding an appropriate solution ahead of setting longer term incentives from 2013.

As we set out in our final proposals it was difficult, particularly in the context of a roll over approach to setting incentives, to identify additional cost-beneficial actions that NGG could take with regard to UAG. We are however, considering a wide range of options ahead of setting SO incentives from April 2013.

On provision of information, one respondent suggested that NGG should be incentivised more strongly to achieve better levels of data availability and timeliness at times when the market would value this the most, such as days of gas balancing alerts. We consider that this proposal requires further consideration and consultation, and would go beyond rolling over the existing incentives. Again we note that our review of incentives from 2013 will look more widely at all aspect of NGG's SO incentives.

On demand forecasting, NGG expressed some concern that our approach to setting the demand forecasting incentive would leave it with a financial loss on this incentive. One

¹ This letter is available at:

http://www.ofgem.gov.uk/Markets/WhlMkts/EffSystemOps/SystOpIncent/Documents1/Final%20proposals%20gas%20SO%20incentives%202012_13.pdf

² UAG is the energy that remains unallocated after accounting for all measured inputs and outputs from the NTS, own use gas consumption, CV shrinkage and the change in NTS linepack.

point NGG raised attention to in particular was the effect of what it considered to be Ofgem's rounding down of NGG's proposed demand forecast adjustment factor. As we set out in our final proposals, our approach to setting the adjustment factor reflected our view that levels of historical error should not be automatically incorporated into future targets and that the increase in difficulty of demand forecasting may not increase in a linear relationship with storage capacity. For example, there may be potential to learn from experience and different sites may not be perfectly correlated.

After considering the two responses to our final proposals we believe it remains appropriate to direct the licence modifications to be made in line with those proposed.

Should you wish to discuss any aspect of the SO incentive schemes please contact Mathieu Pearson (Mathieu.Pearson@ofgem.gov.uk).

Yours faithfully,

Martin Crouch
Partner, European Wholesale