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

Promoting choice and value for all gas and electricity customers

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Date: 31 January 2013

Dear Colleague

National Grid Gas System Operator Incentives from 1 April 2013

On 17 December 2012, Ofgem published its Final Proposals Consultation Document in respect of National Grid Gas (NGG) System Operator (SO) incentive schemes to apply from 1 April 2013. The consultation document set out our final proposals for the incentive schemes applying from 1 April 2013. This consultation closed on 22 January 2013 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 reputational incentives for Unaccounted for Gas (UAG) and Operating Margins (OM), the new incentive for maintenance, the new incentive for demand forecasting (D-2 to D-5), and auditing costs which we address below.

On UAG and OM, one respondent suggested that they considered levels of UAG on the NTS in particular placed a significant cost on industry (and ultimately consumers) and that our proposals for reputational incentives in these two areas were relatively weak compared to a potential cost incentive. The respondent also suggested that given the move from short-term schemes to an eight year scheme that it would have been prudent to factor in a mid-period review in addition to the uncertainty mechanism.

In respect of UAG, as we set out in our final proposals we do not consider that it is possible to put in place a financial incentive at this time. We have extended the licence requirement in respect of identifying the causes and reporting of UAG to include NGG engaging with stakeholders in investigating the causes of UAG. With regards to the need for a mid-point review, we consider that this is unnecessary as we have said that when work undertaken by NGG or stakeholders identifies solutions to reducing levels of UAG we would consider the most appropriate ways for those solutions to be implemented, which could include deciding to introduce further incentives on NGG before the end of the 8 year period.

In respect of OM, as we set out in our final proposals we consider that we are placing an appropriate and up to date reputational incentive to promote competition in the procurement of OM services, with a reporting regime to ensure transparency. With regards to the need for a mid-point review we consider that this is unnecessary as we noted that if costs increased from current levels or that we did not consider that they represent value for money for consumers we would reconsider whether it is appropriate to put in place a cost incentive.

On the maintenance incentive, one respondent noted the proposed value of incentives differed in respect of "saved" and "changed" maintenance days and suggested that this did not appear to be consistent with the supporting text.

We consider that our final proposals were clear both in respect of the value of the incentives and the underlying rationale.

On the demand forecasting incentive (D-2 to D-5), one respondent noted that the consultation was silent as to whether there was an intention to renew the incentive after it expires in 2015.

We intend to monitor NGG's performance against the incentive before reaching a view as to whether a new scheme should be implemented on its expiry and, if so, what form that scheme should take.

One respondent suggested the insertion of cost recovery mechanisms for three specific audit requirements. We consider that the SO internal costs calculated in RIIO-T1 was our overall assessment of the required revenues for the SO to be able to carry out its activities. We do not include line items in this allowance for each item such as those suggested by the respondent. However, we are confident that the funding reflects our view of the efficient level of revenue for the SO to deliver its outputs.

One respondent also raised a number of detailed points in relation to the draft licence conditions. In light of this response, we have made a number of minor alterations to the draft licence conditions. These are set out in the Direction notice published today. The changes are for the purposes of amending minor typographical errors and clarifying drafting to more accurately reflect the intention set out in the final proposals document. We have not made any changes that affect the material financial value of the incentives or that alters the policy intent set out in our final proposals consultation.

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 scheme please contact Graham Knowles (graham.knowles@ofgem.gov.uk).

Yours faithfully,

Emma Kelso
Associate Partner, Wholesale Markets