

10 December 2009

John Perkins  
National Grid Gas  
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Warwick  
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Dear John,

### **Consumer Focus response to gas system operator incentive scheme initial proposals**

We welcome the opportunity to respond to this consultation. This response is entirely non-confidential and we are happy for you to publish it on your website.

System operator incentives are an important tool in controlling the costs paid by the industry and ultimately by consumers for managing the operation of the National Transmission System. Consumers therefore have an interest in ensuring that they are set with an appropriate structure, at an appropriate level and with appropriate risk sharing.

We have set out our main comments below.

We consider that as a guiding principle a one year approach should be adopted for the time being. This should not preclude longer durations for discrete costs with known drivers, for example for the residual balancing scheme or the environmental incentive scheme. But the imminence of the commencement of the next transmission price control review means that longer schemes should run for no longer than two years, or three years should Ofgem decide to implement TPCR5 from 1 April 2013 with an interim roll-over year.

We support the level of unbundling in the gas scheme. We agree with National Grid that, given the lack of interactivity between the separate schemes and the different performance measures in place, there is little merit in implementing any changes in this respect. We consider that it is the

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process of focusing on the different sets of costs and their different drives that makes moving to longer term schemes a feasible option but only after the forthcoming price control review.

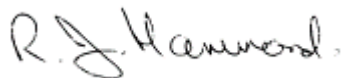
On environmental incentives, we support the view that it is not appropriate to introduce further incentives at this time, particularly as many of the proposed developments are at the feasibility study stage. We also note that some of the proposed developments are capital intensive and may require funding through the price control. But National Grid is keen to promote its corporate responsibility as a company and we would encourage it to examine carefully what improvements can be made without the requirement for further incentives for the changes it thinks are needed. More generally we need to move away from the mindset that National Grid will only consider innovations if they are underwritten by consumers.

We believe the process this year has represented a further improvement over previous years, with focused consultations, greater stakeholder engagement and a more lucid set of proposals from National Grid. Going forward, assuming this model is replicated, we believe it could be enhanced by the earlier availability of Ofgem's own thinking on the main structural issues.

We have responded to the detailed questions and these are set out in a separate appendix.

If you have any questions in relation to our response please contact my colleague Richard Hall on 020 7799 8042.

Yours sincerely,



Robert Hammond  
Head of Regulated Utilities

## **Appendix - responses to consultation questions**

### **2.1 Do you agree with National Grid's conclusion that no changes to the level of scheme bundling/unbundling are required?**

Yes, see also our comments in the covering letter. The lack of interaction between the separate elements of the scheme and the greater level of transparency provided by them supports our view that they should remain unbundled.

### **3.1 Do you believe that the residual balancing incentive should be retained in its current form?**

Yes. We agree with National Grid that it is important to allow time for the new incentive to operate, including through winter periods, before any conclusions are reached on the need for further refinements.

### **3.2 If you believe one of the alternatives should be adopted, which one would you support and would you propose any changes to the proposed scheme parameters?**

We consider that the current scheme should be retained for the time being.

### **3.3 Would you propose any other changes (including the PPM) to any aspect of the residual balancing incentive?**

No.

### **3.4. Would you support the setting of the incentives for two years?**

Yes, we see no reason why some incentives cannot be set for two years. We support National Grid's view that a two year scheme would offer the industry stability and predictability of National Grid's residual balancing behaviours.

### **4.1 Should the D-1 13:00 demand forecast incentive be set on an annual, seasonal or daily basis?**

We consider that there could be value in introducing a seasonal scheme to reflect the fact that demand forecasting errors in the summer are on average higher than in winter.

### **4.2 On what basis should the performance target for any demand forecasting incentive be set? What balance between continuous improvement and the increased external driven volatility should be struck?**

We note that National Grid expects demand volatility to increase in 2010-11 and 2011-12, so that any demand forecasting improvements delivered by it may be offset by its impact and therefore not directly observable in the demand forecast error. We agree with Ofgem that in coming to a view on the appropriate structure and target, it will need to consider National Grid's past performance and the potential for efficiencies and external factors to influence its ability to provide accurate forecasts.

**4.3 Would you support the introduction of an incentive around the D-5 to D-2 demand forecasts?**

If there is sufficient evidence that users would find this of benefit. We note that two out of six respondents indicated that they would find this of value.

**4.4 Do you have any comments on the D-5 to D-2 proposed incentive scheme design and parameters, including the target and the value of the scheme?**

No.

**4.5 Are there particular periods of the year when accurate demand forecasts are of increased value? Is it appropriate that any seasonal or daily incentive should have equal value for each season (or day)?**

We do not have a view on this.

**4.6 Are there any barriers to setting two year incentives around the D-1 or D-5 to D-2 demand forecasts?**

National Grid has commented on the increasing levels of volatility expected. The uncertainty in this area suggests that this incentive should be set for one year only at the current time.

**4.7 Should any D-5 to D-2 demand forecasting incentive scheme operate on a simple average of the forecast errors or should a weighted average of the forecast errors be used?**

This should depend on whether there is a significant difference in the value to users of the different forecasts – a weighted average should be used if this is the case.

**4.8 Given the many issues highlighted, are you comfortable with the approach that National Grid is proposing for the NDM forecast?**

We note that this was the area in the first consultation where the most interest was shown around individual components of the demand forecast (four out of six respondents.) It is clear that this is an issue for the industry but we consider that it is not appropriate to incentivise National Grid on this as it is not involved in the production of the NDM forecast. We support National Grid's proposal to continue to investigate the issues and raise these with the industry at an appropriate forum.

**5.1 Do you support National Grid's proposal that OM availability costs should operate on a cost pass through basis for a further year? If so, should utilisation costs also be passed through or subject to a small incentive?**

We agree with National Grid that the focus should be on delivering contestable arrangements. We support the pass through of availability costs for a further year. Given the uncertainty over the entrance of new providers and their possibly different pricing structures we would also support pass through of utilisation costs for this year.

**5.2 If OM was to be incentivised what structure of incentive should be put in place (ie. combined basis or separate availability and utilisation schemes)?**

Please see our answer above.

**5.3 Should a mechanism for funding the financing costs be introduced? Should any funding be provided through the incentive or a change to the UNC?**

Yes, there is an anomaly here that may lead to perverse incentives. We consider that funding should be provided through a change to the UNC. These costs could then form part of any incentive performance measure.

**6.1 Do you support the proposal for recalculating the environmental incentive target for 2009-10 to ensure consistency with the performance measure?**

Yes, this seems appropriate.

**6.2 Do you support the proposed approach, summarised below, to setting the environmental incentive?**

- using the weighted average historic data to set the volume target;
- using DECC's new non traded carbon price;
- retaining the +/-5% deadbands; and
- no requirement for caps and collars.

Yes, these seem appropriate.

**6.3 Are there any barriers to setting the environmental incentive for a two year period?**

No, we consider that a two year incentive would be appropriate as the cost drivers are well-understood.

**6.4 Do you agree with National Grid's view that no new environmental incentives should be introduced from April 2010?**

Yes. We note that National Grid said that the various projects looking at the potential technologies that could reduce emissions are still at the feasibility stage and that none of the technologies are at a stage where they could be widely deployed in 2010-11. But we consider that National Grid should not wait to be incentivised on these developments or wait for the next transmission price control review to incorporate them where they are successful. If these developments can help to reduce emissions then such actions should form an integral part of the company's work to fulfil and realise its corporate social responsibility obligations.

**7.1 Do you support National Grid's view that no maintenance incentive should be introduced from April 2010? If not, please explain what incentive you believe should be introduced and how the scheme parameters should be set?**

Yes, there is not sufficient evidence for introducing a new incentive here. But we support Ofgem's view that National Grid should be encouraged to continue to work with the industry to improve maintenance planning, including on the requirements to capture and publish maintenance information.

**7.2 Do you have any suggestions of how the bilateral information provided to parties affected by maintenance could be improved?**

No.

**7.3 Do you support our proposal to publish information on the maintenance process on a quarterly basis? Are there other data items which you believe it would be helpful to capture?**

Yes, provision of this information has been welcomed by users. We have no views on other data items.

**7.4 Do you have any other suggestions of how the maintenance processes could be improved?**

No.

**8.1 Do you agree that the current data publication incentive should be set for a further two years?**

No. We support Ofgem's suggestion that, since the incentive is meant to ensure the maintenance of the current level of performance, rather than seeking further improvements, it would be appropriate to retain a negative incentive only for this scheme. We do not see any barriers to setting the scheme for two years.

**9.1 Would you like to make any other comments on SO incentives that have not been captured through the other questions in this document?**

No.

**9.2 Are there other areas where you believe there would be benefit from introducing a new SO incentive?**

We have not identified any further areas.