



**National Grid Gas (NTS) SO Incentives for 1 April 2009**  
**Initial Proposals Consultation**  
**Comments from AEP<sup>1</sup>**

The Association welcomes the opportunity to respond to this consultation. Where appropriate we provide comments to the questions as detailed below.

*Question 1 Do either of the two residual balancing schemes presented better reflect an appropriate balance between driving minimal residual balancing and correct allocation of costs?*

We believe that scheme A is better than the current scheme and scheme B in that it provides a stronger focus on price relative to managing linepack within an artificially narrow range. We believe that this scheme will further minimise residual balancing actions, with less intervention generally being a good thing, given the consequential effects on prompt prices.

*Question 2 Do you have any comments on any aspects of the scheme(s) features or parameters (including the performance target, the daily caps/collars, the balance between the strength of the LM compared to the PPM) ?*

It is disappointing that NG has not provided more analysis of past performance and how that might look under the proposed schemes. We acknowledge that a different scheme should encourage different responses but nonetheless this would have been a useful benchmark comparison. In the absence of this analysis it is difficult to formulate a view on the incentive parameters. However given past performance it may be appropriate to strengthen the price incentive, perhaps by reducing the price measure % to 7% but retaining the cap at £5,000. Otherwise we are concerned that this could be revenue enhancing for NG. Following the slackening of the linepack incentive we would expect there to be actions on fewer days such that NG would receive the capped payment on more days and therefore enhanced incentive rewards, even if the parameters are unchanged.

*Question 3 Should this incentive be reviewed periodically (e.g. annually) or only when there is a specific need to?*

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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.

Performance under the incentives should be reported routinely to the industry at appropriate fora and reviewed annually.

*Question 4 Do you think it is appropriate to have a separate incentive on UAG? Do you agree that this should be a long term incentive?*

We agree that it is appropriate to apply a separate incentive on UAG, although we have some reservations as to whether some of the proposed actions are things that should be being undertaken even absent an incentive. We understand the need for this to be a longer term incentive, but given that it is a new scheme consider 3 years would be more appropriate than 5.

*Question 5 Do you agree with the proposed UAG incentive and do you have any comments on the specific proposals outlined (including whether a scheme should be based around gross UAG and whether the proposed target and incentive value are appropriate)?*

Since UAG represents a mis-allocation of costs we agree that a scheme based on gross rather than net is appropriate. We agree that the approach to setting the target and incentive value is reasonable.

*Question 6 Do you believe that any limits should be applied to the proposed scheme? Please describe how best to achieve this e.g. by suggesting a deadband, cap or method for resetting the target?*

Setting the target based on a rolling average of past x years outturn may be appropriate to maintain the strength of the incentive.

*Question 7 Do you believe there is an alternative proposal that would better incentivise reduction of UAG volumes?*

Not at this time – given that UAG is not well understood

*Question 8 Do you agree with the shrinkage volume forecasts? Do you have any comments to make?*

The forecasts seem reasonable

*Question 9 Do you support using outturn flows at St Fergus as a target driver for the compressor fuel forecast?*

This methodology still seems to be appropriate.

*Question 10 Is there still a requirement to have bands around the compressor fuel volume target or should the continuous relationship be used?*

A continuous relationship would maintain the incentive but avoid the windfall profit and loss associated with the banding.

*Question 11 Do you believe it is appropriate to review the GCRP uplift?*

A review would seem timely

*Question 12 On what basis do you believe the GCRP Uplift should be set for 2009/10 (e.g. storage based or market based)?*

The Association does not have a strong view on this

*Question 13 Do you agree that the outturn UAG volumes should be passed through this scheme?*

Yes

*Question 14 Do you have a preference between an annual or quarterly scheme (as described in options 1&2)? Under a quarterly scheme how should quarterly caps and collars be set?*

We consider reverting to an annual scheme would be appropriate with minimizing the cost of shrinkage to the industry.

*Question 15 Do you have any comments on any of the parameters (e.g. caps, collars, sharing factors) of the scheme and the duration that the scheme should be set for (e.g. 1,2 or 3 years)?*

*Question 16 Given the uncertainty over the impact of OM contestability, do you support passing through the OM holding costs for 2009/10, subject to Ofgem scrutiny?*

This seems like a reasonable way forward.

*Question 17 If not do you have any suggestions on how OM could be incentivised for 2009/10?*

*Question 18 Do you support the proposal to keep the existing OM utilisation incentive?*

This also seems reasonable for now, but will need to be reviewed going forward as the balance of holding costs and utilization costs may change for new providers.

*Question 19 Do you agree with the proposal for the continuation of the existing historic average approach for setting a volume target for gas turbine driven compressors?*

YES

*Question 20 Which option do you support to best reflect environmental costs associated with the venting of natural gas?*

Option 1 since this includes the environmental impact of other constituents of natural gas.

*Question 21 Do you support the proposed parameters (including the 3.2% target) for an annual Demand Forecasting Incentive?*

Yes – given the importance of accurate demand forecasts to the market.

*Question 22 Should the incentive be set for more than one year?*

There is no rationale presented by NG for setting this for more than a year, eg longer term projects to deliver greater accuracy.

*Question 23 Do you agree that the current Data Publication incentive should be rolled forward unchanged?*

No, it should probably be removed as improvements have now been made.

*Question 24 Do you believe this incentive should be set unchanged for the remainder of the price control period (2012)?*

No

*Question 25 Should the funding arrangements for upgrading the website be made enduring or be removed?*

The funding arrangements have been sanctioned for MIPI phase 2 so its not clear what this would deliver?

*Question 26 Do you believe that the package of incentives are designed to drive the desired behaviours from the System Operator, providing the right balance between risk and reward?*

We consider the package does deliver an appropriate balance between risk and reward

*Question 27 Do you have any other comments on SO Incentives?*

Going forward it may be appropriate to consider incentives in relation to maintenance planning.

19<sup>th</sup> December 2008