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Dear John

**EDF Energy Response to National Grid Gas (NTS) SO Incentives for 1 April 2009**

EDF Energy welcomes the opportunity to respond to National Grid Gas' consultation on the design and structure of SO Incentives from April 2009. We have provided some general comments in this covering letter with more detailed comments in the attached appendix.

This is the second year NGG has led the development of its SO Incentives and we believe the process has worked well. The level of communication and organisation is good although we note that this year NGG has not published its actual performance to date under these incentives. This has made it difficult to assess the appropriateness of some incentives and to gauge how much they need to be strengthened or loosened. Publication of this data in future SO Incentive reviews would help the industry better understand how well some of the incentives are working and whether they are generating the most appropriate behaviours and levels of efficiency that they are designed to do.

The incentives, and their interaction with one another, are complex and we believe there is merit in exploring the dynamics which are created to ensure they still remain challenging over and above RPI-X methodology. If National Grid Gas is easily able to meet their targets then we have to question their utility as drivers for efficiency.

We also believe that there could be more debate earlier in the process could have helped to develop some more alternative options. This would better engage interested parties and lead to more detailed debate on the merits of some incentives which could lead to more efficient incentive outcomes. Also, it would be useful if more in-depth discussion was held on particularly complex incentives dynamics where the greatest costs lie, such as Shrinkage and Balancing.

I hope you find these comments useful, however please contact my colleague John Costa ([john.costa@edfenergy.com](mailto:john.costa@edfenergy.com) , 020 3126 2324) if you wish to discuss this response further.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'Seb Eyre'.

Dr. Sebastian Eyre  
Energy Regulation, Energy Branch

Cc. Ofgem

## Appendix

### Residual Balancing

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?
Balancing	<ul style="list-style-type: none"> <li>We do not believe the new options represent a symmetrical risk/reward balance than current balancing incentives. especially considering that NGG has performed well under current incentive in place.</li> <li>NGG has increased the target level to 2.8mcm and reduced its downside exposure from 20 to 15mcm at same time without decreasing reward levels thereby creating less risk for NGG despite it not being clear whether system balancing has improved as a result of market behaviour or NGG action. We recommend the current incentive structure is rolled over as is.</li> <li>We agree with the incentive to minimise NGG's actions in the market however NGG should not be rewarded where no action has been taken where the system brought it itself into balance. We would like to see an indicator on days where no action was taken to show that this was a result of NGG's active system management before gaining reward under the incentive. We recognise that this may be difficult and complicated in practice in which case Ofgem may think about just lowering the reward if they believe it is too slack.</li> <li>We recommend PPM option A is better than B given that B is the same as current incentive. However, unfortunately we do not have any performance data to say anything needs changing.</li> </ul>
PPM	
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) ?
	<ul style="list-style-type: none"> <li>We agree annual caps and collars should remain unchanged at +/- £3.5m</li> </ul>
Question 3	Should this incentive be reviewed periodically (e.g. annually) or only when there is a specific need to?
	<ul style="list-style-type: none"> <li>We believe it should be reviewed annually</li> <li>On the topic of "intra-day" transfer service we believe this has some merit and believe it should be developed further to ascertain whether it has any long-term value,</li> <li>On the topic of Line Pack manager we believe this has little value and may create extra risk for the system and consumers.</li> </ul>

### Shrinkage

Question 4	Do you think it is appropriate to have a separate incentive on UAG? Do you agree that his should be a long term incentive?
	Yes, however, we believe it should only be a one year incentive to begin with to assess its effectiveness before committing to a longer period. However, it is unclear to what extent NGG can influence/ reduce UAG levels considering it only owns 15% of NTS entry and exit meters. Furthermore, given that most of the entry meters do not belong to NGG it would be useful to know whether NGG and Ofgem has the jurisdiction to regulate these meters.

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)?
	We agree that the incentive should be based on gross UAG volumes as the focus should be on reducing total misallocation.
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?
	It should either be annual target based on lowest level of UAG in past 5 years or a rolling target based on average UAG levels for the past 5 years.
Question 7	Do you believe there is an alternative proposal that would better incentivise reduction of UAG volumes?
	A proposal that includes a downside risk as well up side is more challenging. This downside could be rewarded by increasing level of payment as £7k/Gwh works out to only 0.00205p/th which is small given that over £40m/ year is lost through UAG.
Question 8	Do you agree with the shrinkage volume forecasts? Do you have any comments to make?
	The forecast cannot be verified by us. More information on daily shrinkage volumes and performance against forecast would be useful.
Question 9	Do you support using outturn flows at St Fergus as a target driver for the compressor fuel forecast?
	Use of St. Fergus compressor fuel costs as the target driver should only be used to the extent that it can be correlated to compressor usage across the system. As more gas imports arrive in the UK we would expect the target driver to move southwards.
Question 10	Is there still a requirement to have bands around the compressor fuel volume target or should the continuous relationship be used?
	It seems sensible to continue to use the continuous relationship.
Question 11	Do you believe it is appropriate to review the GCRP uplift?
	A review at this stage seems appropriate due to NGG's concern over its exposure to prompt prices. However, NGG's exposure to prompt prices is only 25% and therefore any change would not be significant.
Question 12	On what basis do you believe the GCRP Uplift should be set for 2009/10 (e.g. storage based or market based)?
	We would support the market based ex-post over the ex-ante incentive to reflect the inherent flexibility NGG has in managing the NTS.
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 believe the quarterly scheme is more appropriate as determined originally as it means that any over/ under performance is contained to a quarter, preventing excessive gains or losses for NGG/ consumers.
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)?
	We believe parameters should continue to be a yearly scheme at this stage in the absence of more in-depth analysis to show a longer-term scheme is more appropriate.

## Operating Margins

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?
	Given the uncertainty of how the new contestable contracts for OM services will work it would seem appropriate to pass through the costs for one year only, however only the OM Contestable services costs over and above NGG's current allowance. We would recommend an absolute ceiling to cap costs.
Question 17	If not do you have any suggestions on how OM could be incentivised for 2009/10?
	Not at this stage given the lack of historical performance information.
Question 18	Do you support the proposal to keep the existing OM utilisation incentive?
	Yes.

## Environmental Incentive

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?
	<ul style="list-style-type: none"> <li>We believe the averaging target figure is an allowance and therefore at the average level would equate to 100% allowance level given the small variance in emission volume between years. This dilutes the incentive and therefore we believe the lowest recorded figure should be used, especially if NGG are planning to convert to electric compressors in the near future.</li> <li>We would expect the volumes in this incentive removed from NGG's Shrinkage incentive target so that there is no risk of double counting.</li> </ul>
Question 20	Which option do you support to best reflect environmental costs associated with the venting of natural gas?
	<ul style="list-style-type: none"> <li>We do not believe the Defra carbon shadow price is the most efficient reference price to use for this type of industrial process as it is a social carbon price. It would be more appropriate and efficient to use current EU ETS carbon price as is the relevant reference price used in mitigating CO2 emissions. It would also put NGG on a level playing field with other industrial sectors.</li> </ul> <p>In our response earlier this year on this incentive we stated the objective was to reduce emissions in the most cost effective way. In order to assess whether creating a link to a shadow carbon price is the most efficient and effect way of reducing emissions it would be useful if NGG could provide:</p> <ul style="list-style-type: none"> <li>NGG's marginal cost of abatement to understand if this incentive is sufficient to invest in alternative technologies and provides an effective mechanism to reduce emissions.</li> <li>The cost of replacing gas compressors with electric compressors as per NGG's strategy to ascertain whether this cost would outweigh the cost that NGG is receiving through this incentive?</li> <li>In terms of switching to electrical compressors we would like to know what the impact of this would be on security of supply especially in the case of a major power outage.</li> </ul>

### Quality of information – Demand Forecasting

Question 21	Do you support the proposed parameters (including the 3.2% target) for an annual Demand Forecasting Incentive?
	We believe the original 3% target would still be more appropriate as we believe predicting Milford Haven LNG and new storage flows will not change NGG's level of demand forecasting performance any better or worse than now.
Question 22	Should the incentive be set for more than one year?
	If set for more than one year it should be based on a decreasing target to reflect better performance. Also, we believe this incentive should be linked to the Balancing incentive as it could be NGG's forecast error that led to much if the system imbalance. More work on this would be welcomed.
Question 23	Do you agree that the current Data Publication incentive should be rolled forward unchanged?
	Yes.
Question 24	Do you believe this incentive should be set unchanged for the remainder of the price control period (2012)?
	No.

### Quality of information - Data publication

Question 25	Should the funding arrangements for upgrading the website be made enduring or be removed?
	We believe to should be removed as NGG has stated it has maxed out on this incentive as there are no more improvements to be made without excessive cost.
Question 26	Do you believe that the package of incentives is designed to drive the desired behaviours from the System Operator, providing the right balance between risk and reward?
	Given that NGG has stated that there is little scope for improvement there is little merit in continuing to reward NGG and it may be best to set this level of performance in stone as part of its RPI-X performance.
Question 27	Do you have any other comments on SO Incentives?
	It may be appropriate to have an incentive on maintenance planning to ensure maintenance periods are taken efficiently by NGG by aligning it with Users' maintenance plans.