

National Grid

By email to soincentives@uk.ngrid.com

Date: 4 August 2011

Dear Sirs

System Operator incentive schemes for April 2012 initial consultation

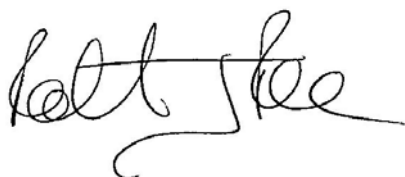
EDF Energy is one of the UK's largest energy companies with activities throughout the energy chain. Our interests include nuclear, renewables, coal and gas-fired electricity generation, combined heat and power, and energy supply to end users. We have over five million electricity and gas customer accounts in the UK, including both residential and business users.

We welcome the opportunity to respond to this consultation and provide our views on the SO Incentives for 2012 / 2013. The key points of our response are:

- Any reform of the roll over incentives for the period 2012-13 needs to be proportionate and therefore we would expect minimal changes, in line with the price control roll over.
- Unaccounted for Gas (UAG) remains a key issue; the importance of which should continue to be reflected in the risks and rewards available to National Grid (NG).
- We are concerned that since 2009 UAG has increased and now stands at 5TWh – equivalent to over £100m of "missing" gas. It is important that NG is incentivised to ensure sufficient management and resource is attached to the reduction of UAG, the first step of which should be enforcement of contractual requirements.
- We note that the shrinkage incentive and UAG incentive are equivalent in value, both in terms of costs to consumers and incentive payments to NG. However, NG in this consultation seems to have focused greater effort on shrinkage compared with UAG.

Our detailed responses are set out in the attachment to this letter. Should you wish to discuss any of the issues raised in our response or have any queries please contact my colleague Stefan Leedham on 020 3126 2312, or myself.

Yours sincerely,



Rob Rome
Head of Transmission & Trading Arrangements

Attachment

System Operator incentive schemes for April 2012 initial consultation

EDF Energy's response to your questions

Question 2.1

Are there any additional items which require consideration for the roll over of the shrinkage incentive?

The list on page 11 of the consultation document represents the type of uncertainties which a gas System Operator (SO) may face. We agree with Ofgem's view that the compressor fuel use at St Fergus and Milford Haven warrants further review, but note that any amendments to incentives for the one year roll over period of 2012 – 2013 should be proportionate to the possible achievable benefits.

Question: 2.2

What is the appropriate level of change and what are your priorities for the rollover of current arrangements in respect of the Shrinkage Incentive for a single year scheme for 2012/13?

The performance of National Grid (NG) against its 2009/10 and 2010/11 targets produced net benefits for consumers. However, given the costs involved in shrinkage procurement it is appropriate for NG to continue to focus its efforts on effective procurement and risk management strategies to reduce the cost of shrinkage purchased. NG should continue to focus efforts on the reduction of shrinkage volumes as these represent a significant cost for shippers.

Question 2.3

Do you consider a review/update of the current CFU mode appropriate for a rollover year, or do you believe that a more fundamental review is required? If so, what approaches and / or techniques should be explored?

Based on forecasts for 2011/12 performance against the CFU target, it does not seem appropriate or beneficial to continue with the existing methodology, as according to NG this would result in a reduction of the shrinkage volume target by 58%. Any new model must consider greater uncertainty in supply-demand so as to avoid a repeat of this issue. A review of the target methodology would therefore appear appropriate provided that this is proportionate with the duration of the incentive concerned.

Question 2.4

Do you consider TBE base case at seasonal normal demand remains an appropriate supply-demand scenario assumption for CFU target setting?

The TBE base case seems reasonable and is widely used in many industry processes. It is therefore appropriate in setting supply-demand scenarios.

Question 2.5

Do you believe it is necessary to review the CFU adjuster? If so, should this be an update of the current values or a revision of the methodology itself?

We do not believe that a review is appropriate as the need for one is yet to be demonstrated. Any amendments to incentives for the one year roll over period of 2012 – 2013 should be proportionate to the possible achievable benefits. It could be worthwhile to review the CFU adjuster post-2013.

Question 2.6

Are the latest programmed dates for the installation of electric drive compressors an appropriate basis for the disaggregation of the baseline CFU target into gas and electric volumes? If not, what do you believe would be the appropriate basis?

We believe that this is a reasonable assumption for a one year review, provided there are no other impacts. We note the correlation between gas and electricity prices which enables some offsetting in terms of volume and the potential up side to NG and its costs.

Question 2.7

In respect of the shrinkage procurement incentive, do you believe that it remains appropriate for the UAG component of the gas volume target to continue to be based upon net outturn volumes?

This seems appropriate for a one year roll over but we should be reviewed in the medium term. We have concerns regarding UAG volumes, which we will address later in this consultation response.

Question 2.8

Do you believe it is appropriate to maintain the mechanism that enables exclusions (for specific CV risks that cannot be mitigated economically) to be identified within the current incentive structure? If not, how should these risks be accommodated within the incentive structure?

This seems appropriate for the purposes of a one year incentive scheme roll over.

Question 2.9

Do you believe that swing is an incremental cost for which there should be an allowance in addition to the benchmark price?

NG's role as SO is to undertake balancing actions, which include the daily purchase of "swing" volumes. The requirement to better forecast and reduce swing volumes forms part of managing shrinkage for which NG is incentivised. Therefore, it does not appear appropriate that costs incurred as a result of inaccurate forecasting should be subject to an additional allowance.

Question 2.10

Is the current ex-ante market benchmark approach appropriate for the purposes of a one year rollover? If not, what alternative arrangements do you believe are appropriate?

The ex-ante market benchmark seems appropriate for the purposes of a one year incentive scheme roll over.

Question 2.11

Do you believe it is appropriate to review the ECRP reference price uplift?

Due to significant rises in gas wholesale market prices in recent years, there may be merit in review for future years after 2013. For the purpose of this one year roll over, we believe that the effort required for review outweighs any expected benefit.

Question 2.12

Do you believe it remains appropriate for the ECRP reference period within the rollover arrangements to retain a bias to prompt price?

The use of the ECRP remains appropriate – any bias is based on the model which NG has developed and its internal approach to risk.

Questions 2.13

What do you consider is an appropriate incentive treatment of the TNUoS, DUoS and CRCEES costs?

We recognise that these costs are increasing but we have not seen any reasonable arguments as to why they should be the subject of additional or different treatment in SO incentive schemes.

Question 2.14

Do you think it is appropriate to have a bespoke environmental dimension to the NTS shrinkage incentive? If yes, do you believe it is appropriate to review the adjustment for the shadow price of carbon within the 2012-12 scheme to ensure the appropriate level of interaction with environmental legislation?

The industry has historically expressed concerns with the separation of the shrinkage and environmental incentives as NG could potentially be rewarded twice under these separate incentives. However, it does not appear proportionate to review the adjustment for a one year incentive roll over and consider that this should be considered in the arrangements post 2013.

Question 3.1

Do you believe that National Grid has a central role in the minimisation of UAG volumes? If not, who do you believe should take on this role?

Although there is a need to provide incentives to GDNs post 2013; NG remains the central player in minimising UAG volumes. It is responsible for the purchase of gas to cover UAG in its role as SO, and is the contractual counter party for the delivery and offtake of gas from the NTS.

UAG has a significant impact on the allocation of costs to Shippers, with identified meter errors in 2009/10 impacting on the allocation of £60-70m of gas. It would therefore seem appropriate that this output measure remains incentivised.

Question 3.2

If you consider that National Grid has a central role to play, do you believe that National Grid should be incentivised to perform this role or should it be subject to a funded obligation?

NG should be incentivised in the minimisation of UAG volumes. In the context of a one year roll over, it might not be appropriate to consider alternatives.

Question 3.3

If an incentive were in place for UAG in 2012/13, what would an appropriate incentive structure be? For example, the current incentive scheme is based upon the absolute volume of UAG in a year.

A financial incentive should encourage NG to explore new ways of reducing UAG or focusing GDN attention in this area. For example the application of a scheduling charge to GDN Offtake Profile Notice (OPN) submissions might focus attention on accuracy. Shippers are exposed to scheduling charges and coincidentally the number of meter errors in terms of volume and duration are less. Therefore, the development of a financial incentive with risk and reward for NG appears appropriate. There may also be a value in exposing NG to costs when it has not enforced its contractual requirements; for example where failure to comply with a contractual requirement has resulted in additional UAG costs that might have been avoided.

Question 4.1

Do you support the view that the structure of the current D-1 13.00 demand Forecasting Incentive remains fit for purpose for incentivising National Grid to provide valued information for customer? If you do not agree with this view, do you have any views as to how the structure could be improved to apply from 1 April 2012?

It seems an appropriate basis for 2012-13 incentive, but we believe that further work is required post 2013 as we have indicated in our response to Ofgem's consultation on post 2013 SO incentives.

Question 4.2

Do you have any views or evidence regarding the volatility of demand in 2012/13? In addition, do you have any views on how this demand volatility will impact the demand forecast incentive?

We have no evidence that demand in 2012/13 will be any more volatile than in previous periods as no fundamental changes are anticipated.

Question 4.3

If National Grid were able to improve its demand forecasts, how would this impact on your business?

The most significant impact for EDF Energy of National Grids' forecast accuracy is on our NDM forecasting and balancing. Due to the forecasting issues experienced in this market in the April-May period 2011, there were large movements in the D to D+5 NDM energy allocation and imbalance positions. This may have had an impact on shippers' credit positions; should this have occurred in winter, the impact might have been even more significant. Shippers have been concerned with NDM forecasting accuracy and energy allocation for a significant period of time and so it would appear appropriate that this is now subject to an output measure. However, this may be more appropriate for a post 2013 scheme.

Question 4.4

Do you agree with the analysis that we propose to undertake in order to review the annual error target as described in paragraph 140? If you do not agree with this proposed approach, are you able to state which amendments or additions you consider are appropriate to this analysis?

We support NG's efforts to produce accurate analysis on the basis that it is proportionate to the duration of the target.

Question 4.5

What value (or relative value) do you place on each of the demand forecasts?

At time of tight margins the demand forecasts that NG produces may have an impact on the market's view of supply-demand and therefore prices. However, our main focus is on the NDM forecasts and allocation which may be an issue for the post 2013 incentive.

Question 4.6

Which of the forecast times do you believe should be incentivised?

The incentivisation of the D-1 13.00 period seems appropriate.

Question 5.1

What value do users put on the data items that are published under this incentive? In particular, we welcome views from small suppliers and large consumers

We support the publication of transparent and reliable data by NG. Even though classified as a large shipper and supplier, we rely on the data available on NG's public websites.

Question 5.2

Are the current target levels of website availability and timeliness of data publication appropriate?

We note that the reliability of NG's website and the timeliness of data publication are much improved. The impact of this is such that we now predominantly rely on the public website and the data available is frequently used internally.

Question 5.3

Do you agree with our recommendation that the structure of this incentive [the data publication incentive] should not be reviewed for the rollover year in order to allow for a more detailed focus on SO incentive scheme effective from 1 April 2013?

This approach seems appropriate for the purposes of a one year incentive scheme roll over.

Question 6.1

Do you support the view that the structure of the current Residual Balancing incentive remains fit for purpose in incentivising National Grid to not enter the market where possible and minimise [their] impact when [they] do enter? If you do not agree with this view, do you have any views as to how the structure could be improved to apply from 1 April 2012?

The Residual Balancing incentive has been the subject of extensive industry discussions in both 2010 and 2011; given this, it seems appropriate for a one year roll over.

Questions 6.2

Do you support the view that the target parameters of the PPM should be reviewed?

We remain unconvinced of the need for a review of the PPM target parameters.

Question 6.3

Do you agree with the analysis we propose to undertake in order to review the PPM target as described in paragraph 183? If you do not agree with this proposed approach are you able to state which amendments or additions you consider are appropriate to this analysis?

We support the additional analysis, provided that it is proportionate for a one year review.

Question 6.4

Do you believe that the LPM target parameters should also be reviewed?

We are not convinced of the need to for a review of the LPM target parameters.

Question 6.5

If possible, could you provide your views on suitable levels for the residual balancing scheme parameters?

We do not have any specific views on the balancing scheme parameters; however, as previously noted any review should be proportionate to a one year review.

Question 7.1

Is the information as summarised above [quarterly incentive report] useful?

We support the publication of transparent and reliable data by NG.

Questions 7.2

Is there any further data which could be issued by National Grid to improve the level of information available in respect of SO incentives?

We believe that the scope and quantity of the information provided by NG is appropriate and meets users' needs.

**EDF Energy
August 2011**