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National Grid Gas (NTS) System Operator Incentives for 1 April 2012 - Initial Consultation July 2011

Dear Juliana,

Thank you for the opportunity to comment on the proposals for the National Grid NTS System Operator (SO) Incentives. This response is provided on behalf of the RWE group of companies, including RWE Npower plc and RWE Supply and Trading GmbH.

National Grid is seeking initial views on the five SO Incentives that are due to expire on 31st March, 2012. Our current view is that the existing incentives should be subject to a simple one-year rollover. This should be limited in scope, with the current scheme parameters updated where necessary, rather than changes to the underlying methodology. This is a proportionate approach given the concurrent fundamental review into the SO incentives to apply from 2013.

We are concerned about the Shrinkage Incentive and accept that there may be some methodological changes required to account for observed changes in supply patterns onto the NTS. However, we believe that there is an urgent requirement to focus on reducing the volumes Unaccounted for Gas (UAG). The lack of control over UAG and in, particular. metering errors has been a major driver of the volatility and unpredictability in the SO commodity charge that has been experienced.

Our detailed response has been structured as answers to the questions raised in the consultation:

1. Shrinkage

Question 2.1: Are there any additional items which require consideration for the roll over of the Shrinkage incentive?

We have not identified any.

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?

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We support incremental change. Past good performance against this incentive has been mostly down to favourable price movements between setting the reference price and executing the purchases. It is important that National Grid also focuses on assessing the scope for volume efficiency as well as price efficiency. In any enduring mechanism, the influence of windfall gains/losses should be minimised such that the incentive rewards National Grid for improvements in operating the system.

Question 2.3: Do you consider a review/update of the current CFU model 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?

Updating the model is appropriate for the rollover, but may need enhancement beyond 2013 to account for changing supplies and, therefore, flows on the NTS.

Question 2.4: Do you consider TBE base case at seasonal normal demand remains an appropriate supply-demand scenario assumption for CFU target setting?

Yes it remains appropriate.

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?

There is evidence that the adjuster appears to be less robust under extreme supply scenarios. Although we agree that it is important to set a meaningful target volume, we support an update of the current values rather than the methodology itself for the rollover.

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 target volumes? If not, what do you believe would be the appropriate basis?

The latest programme dates are appropriate.

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?

We agree that this is appropriate but believe that the control and monitoring of UAG volumes needs to be more proactively managed and that this might require a different form of incentive from 2013.

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?

We agree.

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?

We agree.

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?

We agree that it is appropriate for the rollover, but longer term there should be consideration whether the use of Rough SBU remains the most appropriate proxy for swing cost.

Question 2.11: Do you believe it is appropriate to review the ECRP reference price uplift?

We agree, but National Grid should face incentives to develop a procurement strategy that minimises the need for uplift.

Question 2.12: Do you believe it remains appropriate for the ECRP reference period within the rollover arrangements retain a bias to prompt price?

We agree.

Question 2.13: What do you consider is an appropriate incentive treatment of the TNUoS, DUoS and CRCEES costs?

These should be passed through as National Grid Gas has no direct control over the level of these costs.

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- 13 scheme to ensure the appropriate level of interaction with environmental legislation?

It may be provided that any allowance under a bespoke environmental incentive is not duplicated by other elements already within the Shrinkage incentive.

2. Unaccounted for Gas (UAG)

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 this role?

As the primary cause of UAG is believed to be inherent metering tolerances associated with entry and exit meters, National Grid clearly has a role, along with the gas DNs, in managing UAG.

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?

We believe that National Grid should face strong incentives to monitor and control UAG in a much more proactive manner.

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.

The current structure should be retained for the rollover year. Changes in the absolute volume of UAG will impact both the level and volatility of the SO commodity charge.

3. Demand Forecasting

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 to *customers? 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 current structure should be retained.

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 views on this matter, although some of the volatility in Q2 21011 may be due to a combination of the unseasonably warm weather and Bank Holidays.

Question 4.3: If National Grid was able to improve its demand forecasts, how would this impact on your business?

An improved methodology might help to address concerns about possible increased volatility of demand caused by changing flows on the future.

Question 4.4: Do you agree with the analysis we propose to undertake in order to review the annual error target as described in paragraph 140 above? 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?

National Grid should undertake the analysis.

Question 4.5: What value (or relative value) do you place on each of the demand forecasts?

No comment.

Question 4.6: Which of the forecast times do you believe should be incentivised?

The 1300 D-1 forecast is important, although we would like to see an additional forecast for D made earlier on D-1, for example at 1000.

4. <u>Data Publication</u>

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.

The information provides a useful overview.

Question 5.2: Are the current target levels of website availability and timeliness of data publication appropriate?

Yes.

Question 5.3: Do you agree with our recommendation that the structure of this Incentive should not be reviewed for the rollover year in order to allow for a more detailed focus on SO Incentive schemes effective from 1 April 2013?

We agree.

Question 5.4: What information, if any, do users consider should be incentivised beyond the existing defined dataset?

We have not identified any additional information at this stage.

5. <u>Residual Balancing</u>

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 our impact on the market when we 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 incentive structure reinforces National Grid's role as residual balancer.

Question 6.2: Do you support the view that the target parameters of the PPM should be reviewed?

We support tightening the incentive.

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 above? 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?

There is always difficulty in determining cause and effect from any analysis. While we are not opposed to National Grid undertaking the analysis, we still believe that this should not prevent the target parameters being reviewed for April 2012.

Question 6.4: Do you believe that the LPM target parameter should also be reviewed?

We continue to believe that a linepack measure may not be needed, but this is probably a matter for 2013 rather than 2012. For the avoidance of doubt we are not advocating the development of a linepack service to replace it.

Question 6.5: If possible could you provide your views on suitable levels for the residual balancing scheme parameters?

The parameters need to stretch National Grid.

6. <u>Information on Incentive Performance</u>

Question 7.1: Is the information provided as summarised above useful?

Yes.

Question 7.2: Is there any further data that could be issued by National Grid to improve the level of information available in respect of SO Incentives?

More timely updates of actual recovery against target recovery.

We hope these views are helpful and if you wish to discuss any aspect of them in further detail, please do not hesitate to contact me.

Yours sincerely,

By email so unsigned

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