National Grid Gas (NTS) System Operator Incentives for 1 April 2012 – Initial Consultation
AEP[1] Comments

The Association welcomes the opportunity to comment on this initial consultation, although we note the length, detail and complexity of the questions may be a step beyond what is necessary for a roll over period. We also note that there tend to be relatively few responses to SO incentive consultations and have some concerns that views expressed from a small number of respondents may become 'industry views' even when much of the industry has not provided any response. We also consider that information asymmetry between NG, industry and Ofgem is an issue and it may be appropriate for Ofgem to have a greater role during the development process.

We provide comments to the questions posed where appropriate.

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

No, the key elements of CFU, CV shrinkage and UAG are included.

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?

We note NG has performed well against this incentive in the past two years although it argues this is mostly down to price movements rather than volume reductions and as such may not be seen in a rising market. However for a rollover year incremental change would seem appropriate.

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?

[1]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.

A review of the current model would seem appropriate for a rollover year so long as it includes the relevant drivers of CFU for setting the target.

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, but nothing else is suggested.

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?

NG have reported that the CFU adjuster has worked well in the past to account for variations in flows at St Fergus but is beginning to observe that the linear relationship is beginning to break down at lower St Fergus flows. In this context we would agree that a revision of the methodology would seem appropriate.

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?

As this seems to be the latest available information it would seem appropriate to use these dates, else it's not clear what other approach would form a reasonable alternative.

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?

Our understanding is that the UAG incentive is based on absolute / gross values i.e the sum on each day irrespective of whether it is positive or negative. We consider this approach should continue for the rollover period due to the misallocation of costs this represents.

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 consider it is appropriate to maintain these exclusions since it is only appropriate to set incentives that the party being incentivised has influence to control the outcome. However we note that this element has not been used in recent years, but represents a low probability high impact event if such scenario were to occur.

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?

Yes

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?

In the interests of simplicity for the rollover this seems appropriate.

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

The price setting process should to some extent mirror the contracting options available to NG. We would expect that as NG becomes a larger customer, as more electric drive compressors are commissioned, that more sophisticated risk management options would become available to it. However for the rollover period only minimal change should be considered.

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

Where there is short term volume uncertainty continuation of a prompt price element would seem appropriate if this is reflected in contracting arrangements.

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

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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?

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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?

Yes, no one else is better placed to seek to better understand and improve the UAG position. That said we do recognise the work NG has undertaken as detailed in its letter of 16 June to identify possible causes of UAG, clearly there has been some success here. Although we do accept that some level of UAG is an inevitable feature of a large complex network.

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 NG should continue to be incentivised. We note that from 2001/02 to 2007/08 gross UAG was below 3,000GWh[2] whilst in 2003/04 the net position was negative. Whilst in recent years the gross UAG is now more than double the historic position, with the net position being large and positive leading to increased SO commodity charges.

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.

For the rollover year the current structure would seem appropriate although it may be appropriate to reset the target level for the absolute or gross volume to a value just below the current corrected value of 5,000 GWh. A move to funded activities in this area should be considered as part of RIIO once it is better understood what those activities should be.

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 remains fit for purpose

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?

[2] http://www.nationalgrid.com/NR/rdonlyres/D8E0111F-5E59-4390-A6EF-A26BA444CC28/29689/SOIncentivesInitialProposals_v10.pdf

The Association has no evidence on this but wonders whether the demand volatility is linked to weather volatility, NG may wish to explore this

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

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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?

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

We understand that the D-1 1300 forecast is the most valued by industry.

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

For the rollover period this should continue as the D-1 1300 forecast.

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 screens and data are useful for providing a summary overview of the supply demand situation and for ad hoc analysis, particularly for organisations that do not download large amounts of data routinely.

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

Yes – It is desirable for information to be available when needed

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?

Yes

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

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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?

We broadly agree with this view

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

We consider the PPM is an important element of the incentive package given the interaction with gas wholesale market prices, and support Ofgem's view here. In each of the last three years NG has exceeded the target set and received an incentive payment. At some point we may reach a level where any further improvement is unlikely but its not apparent that point has been reached yet.

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?

The analysis of within day price spreads and shipper balancing behaviour at different times in the day would be interesting, but there should be caution in applying short term trends in the longer term as these may have been impacted by other factors such as demand forecasting and the severe weather at the beginning and end of 2010. We do not believe NG should try to predict any change in shipper behaviour arising from the implementation of Mod 333A until some time after this has been implemented. There were extensive discussions of this during the development of mod 333 and 333A but these were inconclusive and did not feature as part of the justification for the proposal.

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

No, we do not consider this is necessary for the rollover.

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

Price performance measure of 2% would seem to represent a reasonable target given that a lower level has been achieved in the past.

Question 7.1 Is the information provided as summarised above useful?

Yes. Providing a graphical representation in addition to the data aids interpretation.

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?

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We would be happy to discuss these issues further, to do so please call Julie Cox on 01782 615397.

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Association of Electricity Producers
Charles House
5-11 Regent Street
London
SW1Y 4LR
Tel: 020 7930 9390
Fax: 020 7930 9391
Email: jcox@aepuk.com
www.aepuk.com