National Grid Gas (NTS) System Operator Incentives for 1 April 2010
Consultation Document 3 – Operating Margins: Contestability Update and Incentives
Comments from AEP[1]

The Association welcomes the opportunity to comment on this consultation document.

Question 3.1 Are there any other activities that National Grid could reasonably do to promote a contestable market and to make a successful safety case demonstration?

The Association considers that the steps previously taken; workshops bi-lateral meetings etc were appropriate in promoting a contestable market. The steps being taken to demonstrate the requirements for a material change to its safety case also seem to be suitable, but ultimately the HSE will determine that.

Question 3.2 What additional information would be useful if provided within National Grid's Invitation to Tender (ITT) documentation or Tender Information Report?

We believe the information provided to be adequate.

Question 4.1 Has National Grid sufficiently articulated the requirement and potential market for OM services?

The graphical representation in Section 4 by OM type provides a useful summary of OM requirements and potential participants for OM services.

Question 4.2 Do you believe the new provider types, if approved through the

[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.

HSE Demonstration case, could form a significant component of future providers of OM?
- NTS Industrial?
- NTS Power Stations?
- Supply Side (Excluding LNG Importation Facilities with Storage)?

Yes, we believe new provider types could offer a reasonable proportion OM services if the contracting structure is appropriate and providing the service is commercially and operationally viable.

Question 4.3 Have you any comments in relation to the potential interaction between demand side provision of OM services and the electricity market?

As CCGTs can only provide Group 1 and 2 services it is not inevitable that the electricity system will be stressed at the same time as OM is required on the gas system. Also since there is a minimum of a two hour notice period for calling OM, generators should be able to manage their gas position either physically within their portfolio or commercially. We recognise that CCGTs may also provide services to the electricity system such as frequency response, fast reserve etc, but consider these can be managed within commercial frameworks, since under normal operating conditions CCGT output levels will vary in response to commercial and operation needs.

Question 5.1 Does National Grid's proposed 2010 OM tender timescale affect, either positively or negatively, the ability for providers to participate?

For potential new providers it would be helpful to know as soon as possible whether the HSE accepts the revised safety case, in order to have adequate time to consider and prepare any responses to tenders issued in Jan 2010. It is our understanding that the HSE assessment for a material change can be completed within a month, so we urge NG to seek clarity on this as soon as possible rather than only just prior to the tender being issued.

Question 5.2 Is there any additional information which could be provided by prior to the tender which would help potential providers in clarifying their position on whether to participate?

An early notification of whether or not the revised safety case allowing for new providers of OM has been approved would be helpful. Particularly for parties who did not participate in the last tender round.

Question 6.1 Is it appropriate to incentivise Operating Margins given the range of uncertainties? If so, what would be the most appropriate way (e.g. Cost minimisation) to incentivise Operating Margins?

In answering these questions we assume that The HSE approves NG's revised safety case to allow for new providers of OM services.

We accept there are many uncertainties regarding the potential total cost of OM services; in particular given the different cost structures of new providers, the extent to which the market is likely to become competitive and uncertainties over whether or not 'C3 prices' will apply for OM provided by NG LNG facilities. All of these make the conventional cost minimisation target setting approach rather challenging. However since these costs are ultimately passed through to customers it is important that NG secures these services as efficiently as possible either through incentives or regulatory scrutiny in the context of its licence conditions.

Question 6.2 Should the OM Incentive scheme continue to be separated into a 'Utilisation' and 'Availability' element?

We believe that NG should be incentivised with respect to both availability and utilisation costs, however we accept it is difficult to predict utilisation costs as use of OM is infrequent. That said - it is also the case that Utilisation costs only relate to space only contracts so any incentive could favour one contract type or provider over another. Therefore there may be a case for including the utilisation costs associated with space only contracts into the availability incentive.

NG recognises that different service providers have different cost structures; these may manifest themselves in a different balance between option and exercise elements. The costs of exercising OM contracts are passed through to shippers without NG facing any incentive (apart from utilisation costs in relation to space only contracts) to minimise these costs or to consider the fully exercised cost of contracts when selecting contracts. It may be appropriate to consider an incentive in relation to total costs should the contracts be fully exercised to ensure efficient procurement of the services and overall cost minimisation.

Question 6.3 Should National Grid be able to recover a return on the gas held in storage for OM purposes?

Little information is provided here on how any return would be recovered. It is not clear whether this could skew any assessment of tenders in favour of gas in store contracts as opposed to space only or new providers, and as such could have a detrimental impact on the development of contestability.

Question 6.4 What would be an appropriate length of an incentive?

We believe that one year would be an appropriate length of incentive given the early stages of contestability in the market.

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