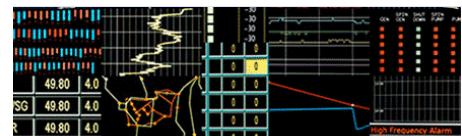


National Grid Gas (NTS) SO Incentive Workshop

Pre Workshop Material

Issued 20 June 2008

nationalgrid



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Section 1 Introduction

1. Last year at Ofgem's request National Grid led the development of Initial Proposals for SO Incentives commencing 1 April 2008. This year Ofgem has again asked National Grid to lead the on the development of Initial Proposals for SO Incentives commencing 1 April 2009. In response to industry feedback received last year, Ofgem initiated this process earlier this year to allow more time for proposals to be considered and developed.
2. In response National Grid issued an Open Letter¹, stating our support for the continuation of this approach and setting out the scope, process and timescales for this year's consultation process.
3. To initiate industry engagement and debate on the issues around SO Incentives, National Grid has arranged an Industry Workshop on the 25th June. Details of the workshop and how to register for it are contained in an Open Letter, issued by National Grid on the 3rd June 2008². The workshop will focus on the Shallow SO Incentives, in particular Shrinkage, Residual Balancing and Operating Margins, which expire on the 31st March 2009.
4. The earlier start of the consultation process this year, has led to some changes to the development process for this year. To put the workshop into the context of this extended consultation process Section 2 of this document describes the process and timescales that National Grid is intending to follow this year. Section 3 shows the agenda for the workshop on the 25th June.
5. Section 4 provides detail of existing SO incentives the issues with these incentives that came out of last year's consultation process. The workshop on the 25th June provides an opportunity to discuss these issues and seek industry feedback on them and any other issues with SO Incentives. To ensure that all parties have sufficient information to be able to fully participate on the day Section 4 also includes some background to the existing SO Incentives.
6. Throughout the process, the SO Incentives area of the National Grid website will be kept updated with all relevant documents. A link to this part of our website is included in the contact details in Section 5 of this document. National Grid can be contacted at anytime using these contact details to discuss any aspects of SO Incentives.

¹ <http://www.nationalgrid.com/uk/Gas/soincentives/docs/>

² <http://www.nationalgrid.com/uk/Gas/soincentives/IndustryWork/>

Section 2 Process

This section provides an overview of the process, which National Grid intends to use, for the development of SO Incentives commencing 1 April 2009. It should be noted that as this process is highly reliant on the input of interested parties.

7. Industry engagement will continue with the workshop on the 25th June, at which National Grid will invite debate on the issues around the existing incentives, Section 3 of this document provides further information on the workshop content.
8. Following the workshop and the feedback received, National Grid will run 'mini' consultations between July and mid September. These mini consultations will be used to facilitate more detailed engagement and debate on specific SO Incentive issues.
9. The outputs from the mini consultations will be used to construct Initial Proposals for incentives to apply from 1st April 2009. Our aim is to issue an Initial Proposal consultation for both gas and electricity incentives at the beginning of November, which will close by Christmas.
10. On conclusion of the Initial Proposals consultation period, National Grid will issue a consultation report incorporating the responses received from interested parties and send the report to Ofgem. In early 2009, Ofgem will then develop and consult on Final Proposals for SO Incentive schemes, prior to their implementation for April 2009.
11. All consultation documents, consultation responses, supporting data and workshop material will be kept updated on the SO Incentives area on National Grid's website³.
12. At any time, National Grid is happy to discuss SO incentives with any interested party. Our contact details can be found in Section 5 of this document.

³ <http://www.nationalgrid.com/uk/Gas/soincentives/>

Section 3 Workshop Agenda

Agenda for the Gas SO Incentives Workshop on the 25th June 2008

Gas SO Incentives Industry Workshop

25th June 2008

Ardencote Manor Hotel
The Cumsey/Lye Green Road
Claverdon
Warwick
Warwickshire
CV35 8LT

Agenda

09:30	Tea/Coffee and registration
10:00	Welcome and opening remarks from National Grid and Ofgem
Morning Session	Physical overview of the NTS Shrinkage Operating Margins Q&A session
12.45	Lunch
Afternoon Session	Residual Balancing Next steps / other issues Q&A session Closing comments

To register for the workshop please e-mail: SOIncentives@uk.ngrid.com

Directions for Ardencote Manor: <http://www.ardencote.com/index.php/location>



Section 4 Existing Incentives

This section provides a description of each of the incentives and highlights some of the key issues for discussion at the workshop.

4.1 Overview of incentives

13. National Grid is subject to a set of System Operator (SO) Incentives which are be designed to encourage efficiency, risk management, investment and innovation, to drive efficient market operation and a lower overall cost of system operation to consumers.
14. A number of these incentives have been agreed for the next 5 years as part of National Grid’s Price Control in respect of the NTS. However some of the current Shallow Incentives expire on 31st March 2009. The table below summarises these Shallow Incentives, which are in the scope of this consultation process.

SO Incentive Scheme	Components
System Balancing	System Reserve (Operating Margins)
	Gas Costs (shrinkage) <ul style="list-style-type: none"> Own use gas (OUG) and electric compressor energy (ECE) Calorific Value (CV) Shrinkage Unaccounted for gas (UAG)
Residual Balancing	Daily Price Incentive
	Daily Linepack Incentive
Quality of Information Incentive	Demand Forecasting
	Website Performance

4.2 System Balancing Incentive

System Reserve (Operating Margins)

15. System Reserve (Operating Margins (OM)) services are purchased by National Grid NTS on an annual basis in line with both the requirements of the UNC and obligations placed on it through its safety case. Primarily, OM gas is used in the period immediately following operational stresses and is used to provide within-day support to maintain system pressures while other remedial actions are taken.
16. To date, OM services have been provided by storage facilities due to their strategic location on the extremities of the network, implicit availability and the high deliverability rates which are necessary for OM purposes.
17. The system reserve incentive encourages National Grid NTS to minimise the storage service costs (space, deliverability, injection, withdrawal, overrun costs). The costs of purchasing and selling gas in storage for system reserve are not part of the incentive and are recovered from shippers through Network Code neutrality arrangements.
18. The current OM incentive is based on total costs but considers holding costs and utilisation costs separately. The holding cost 'target' is derived from forecast volumes and prices and the incentive is essentially an allowed revenue as there are no caps or collars and sharing factors are 100%, due to the fact that National Grid owns the regulated LNG storage facilities that provide approximately 50% of the requirement. The utilisation element recognises that National Grid uses OM for operational rather than commercial purposes and therefore limits its exposure to utilisation costs.
19. Separate to this incentives process, National Grid is leading a project which is looking to widen the pool of potential providers (e.g. demand side provision). The project has been initiated pursuant to a special licence condition that requires National Grid to use reasonable endeavours to promote competition in the provision of the OM service by 1st April 2009. Further information can be found on our website⁴.
20. The ongoing OM Contestability work is considering how OM procurement may develop in the future. OM procurement is becoming increasingly competitive and the time is right to reassess the current incentive structure to ensure that it continues to incentivise appropriate behaviour in terms of procuring the necessary amount of OM in an efficient and economic manner.

Gas Costs (Shrinkage)

⁴ <http://www.nationalgrid.com/uk/Gas/OperationalInfo/GasOperatingMargins/>

21. National Grid NTS undertakes the role of NTS Shrinkage Provider on behalf of the community and procures gas and electricity for this purpose. NTS Shrinkage covers the gas and electrical energy which is used for compression and to cater for gas that cannot be accounted for and billed in the measurement and allocation process. The Gas Cost (Shrinkage) incentive encourages National Grid NTS to minimise the overall cost of procuring gas and electricity to cover the three shrinkage components:
 - Compression Energy – that energy used to run compressors to transport gas through the NTS
 - Calorific Value Shrinkage (CV Shrinkage) – that energy which cannot be billed due to CV capping under application of the Gas (Calculation of Thermal Energy) Regulations 1996 and subsequently amended in 1997.
 - Unaccounted For Gas (UAG) – that quantity of gas which remains after taking into account all measured inputs and outputs from the system, own use gas consumption, CV Shrinkage and the daily change in NTS linepack.
22. The existing incentive structure sets an aggregate shrinkage volume target which is multiplied by a price target⁵ to produce the overall cost target. The incentive operates on a quarterly.
23. The volume target is linked to the average annual volumetric flow through the St. Fergus terminal. This linkage was introduced to reflect the uncertainty over expected flows from St. Fergus, which are strongly correlated with the requirement for compression energy to move gas through the network North to South, from supply source to demand centres.
24. In setting the volume target, it was recognised that in certain circumstances CV shrinkage was outside of National Grid's influence as SO. Ofgem agreed that these volumes should not be incentivised, recognising that going forward there should be a review to explore the scope to modify the CV-capping rules in the DN charging regime.
25. Unaccounted for Gas (UAG) is largely caused by meter errors and is highly volatile with no apparent trend, making future levels difficult to forecast. The total level of UAG is affected by 3rd party owned meters over which National Grid has no direct control. UAG is included in the overall Shrinkage incentive by using a historic average UAG outturn volume.
26. For 2008/9 an interim Gas Cost Reference Price (GCRP) and Electricity Reference Price (ECRP) were agreed. From 1 April 2009 a GCRP with a 75%-25% forward-prompt split was agreed for the remainder of the PCR period. However the ECRP needs to be developed from April 2009.

⁵ GCRP – Gas Cost Reference Price

27. At the workshop on the 25th there are a number of issues that National Grid will be looking to engage with the industry on:
- Should the Shrinkage incentive be split into the constituent parts with different types of incentive to reflect different degrees of National Grid's influence (e.g. recognising that compressor energy is directly under National Grid's control where as UAG is less so?)
 - For each component of shrinkage what is the appropriate form of incentive, including how the target is set and how the target interacts with the pricing methodology?
 - What is an appropriate ECRP methodology for future years?

4.3 Residual Balancing Incentive

28. Shippers are incentivised, via cash-out arrangements, to ensure that the volume of gas that they enter onto the system matches the volume of gas that they take from the system on a daily basis. However shippers (in aggregate) do not always maintain balance, and it falls to National Grid NTS as residual balancer to make trade offs between using linepack, and/or buying and selling gas via the on-the-day commodity market (OCM) to balance the system by end of day, keeping system pressures within operational limits.
29. On any day, should National Grid believe it necessary to take a balancing action on the OCM to resolve an imbalance position, the daily price incentive, incentivises National Grid to trade as close to System Average price (SAP) as possible. By trading close to SAP the impacts of National Grid's trade on market prices on the day are minimised.
30. The daily linepack incentive encourages National Grid to minimise day on day changes to linepack to within a tight tolerance, to avoid shipper imbalances being carried over from one day to the next through linepack.
31. Each element of the residual balancing incentive is calculated on a daily basis and is subject to caps/collars. The overall annual incentive revenue/payment is also subject to and cap and collar.
32. Through the workshop and consultation process, National Grid will be seeking industry views on the existing incentives and whether they incentivise the right behaviour. To support the development of future incentives we will also be seeking a better understanding of how our balancing actions impact on a shipper's own balancing behaviour. To support the development of new incentives (either for April 2009 or for future years) we would also like to explore whether there is value to shippers in making commercial use of the physical tolerances within the system is operated and how this could be facilitated through SO Incentives.

4.4 Quality of Information Incentive

33. The quality of information incentive was introduced in October 2006 to improve the quality of certain information published to market participants, with a view to increasing overall market efficiency.
34. The demand forecasting incentive encourages National Grid NTS to invest in systems and processes to increase the accuracy of its day-ahead demand forecast published to market participants.
35. The website incentive was changed for 2008/9 and now encourages National Grid NTS to maintain current performance levels in respect of the timeliness of key market information that it publishes via its website.
36. Last year's industry responses suggested that this is a low priority area in respect of incentive and therefore National Grid does not have any specific issues on the Quality of Information incentive to raise at the workshop on the 25th June.
37. If parties have specific issues on the Quality of Information Incentive these can be raised during the Q&A sessions, through the mini-consultations or directly with National Grid using the contact details in section 5 of this document.

4.5 Generic Issues

38. In its Open Letter of 12 May 2008, Ofgem raises a number of generic issues that potentially apply across all of the incentives. At the workshop and thought the mini consultations National Grid will be seeking industry views on the following issues.

Multi year incentives

39. Multi year incentives may provide increased scope for efficient investment to reduce overall costs or increase performance over a longer period.
40. Through the consultation process, National Grid is keen to understand the industry's view of multi year incentives, which incentives schemes that they may be applicable for (either for April 2009 or in the longer term). Where there are barriers to moving to multi year incentives, National Grid will be seeking views on what these barriers are and what would need to be done to overcome these.

Changes to incentive year

41. Last year, Ofgem published their SO Incentive Final Proposals document on 27th February 2008, in order to allow for a 1st April 2008 implementation date. In their Open Letter, Ofgem highlighted the time

pressures around these timescales and the desire to include as much data from the winter period.

42. Through the consultation process, National Grid will be seeking feedback from the industry on the appetite for, and the impacts of moving the incentive year, either for all of the incentives or potentially for each individual incentive.

April 2009 Target Implementation

43. Through the workshop and the consultation process, National Grid will be seeking industry views on the areas that can and should be addressed by April 2009 and those areas which should form part of longer term developments. However we are keen to use this year's process to conduct a detailed review and to implement enduring incentives arrangements from April 2009.

Section 5 Contact Details

If you would like to discuss any issue on SO Incentives, please contact us via the contact details below.

To register your interest in receiving future communications on this consultation process please email: SOIncentives@uk.ngrid.com

On the web:

New dedicated web pages for this process are available at the following addresses:

Electricity SO Incentives: <http://www.nationalgrid.com/uk/Electricity/>

Gas SO Incentives: <http://www.nationalgrid.com/uk/gas/>

Talk to us:

Gas

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General enquiries: SOincentives@uk.ngrid.com