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**9th May 2014**

Dear Leonardo,

## **Ofgem Consultation on Gas System Operator incentives review**

### ***Introduction to our response***

Thank you for the opportunity to respond to the above consultation. This response is made on a non confidential basis on behalf of National Grid Gas Transmission (NGGT) who own and operate the National Gas Transmission System (NTS).

We welcome the consultation to review the Maintenance and D-2 to D-5 Demand Forecasting incentives, which expire in 2015 and we also agree that it is appropriate to try and maximise the efficiency of the review process by including the Greenhouse Gas Emissions incentive (due to expire in 2016) within the scope of the review.

Our response below is constructed in line with the associated sections of the consultation, recognising that a number of the consultation questions request our customers' views rather than our own. We therefore feel it is appropriate for us to respond in general to each section of the consultation rather than against any specific questions.

We will be engaging with our customers as part of the incentive review process and will be issuing a detailed incentive plan during early Summer with our thoughts as to appropriate future structures for the incentive regimes. The views gathered from the wider industry to this initial consultation will help further our thoughts and will be reflected within our business plans.

We look forward to working with our customers, stakeholders and Ofgem in developing appropriate incentive structures that help focus on delivering outputs that are most valued by the industry.

### ***Section 1 – Introduction and Objectives***

The consultation proposes to review incentives against specified assessment criteria. The criteria includes: promotes behaviour that is in the interest of existing and future gas consumers, promotes efficient operation of the system, strikes the right balance between challenging and achievable targets and has a value proportionate to potential benefits.

As System Operator (SO) we recognise our role to deliver the key outputs valued by our customers and stakeholders, whilst ensuring we remain focused on the efficient operation of a safe and reliable gas transmission network and delivering value for money for consumers. This role aligns closely to the assessment criteria above in assessing the incentives under review.

The assessment criteria in the consultation indicate that efficient system operation should result in positive changes in incentive performance compared to previous levels. Whilst we are committed to driving continuous improvement against the objectives of the incentives and would expect to see a trend in performance improvements over time, factors that are outside of our control may have an influence on performance on a year by year basis.

We recognise the challenge of setting incentives which both align to the objectives of the review and support the changing dynamics of operating and maintaining the system over a longer timescale. As such we will continue to monitor any implications of regime and operating code changes including those covered by uncertainty mechanisms to ensure that any schemes agreed remain effective. We particularly recognise the potential for evolving requirements from a number of areas, including the European Code changes and the outcomes developed as a result of the Significant Code Review (SCR) on security of supply against the existing suite of incentives.

## **Section 2 – Demand Forecasting**

We publish Demand Forecasts to assist the industry in making efficient decisions to balance supply and demand positions. During the RIIO T1 consultation period, our customers informed us that they valued increased accuracy of forecasts provided prior to the day ahead, particularly under more challenging operational conditions, where risks of prohibitive imbalance costs are higher. As a result a new Demand Forecasting incentive was created to cover the period D-2 to D-5 inclusive; with target performance set based on historical performance levels.

Since the introduction of this incentive we have invested in a number of enhancements to our forecast modelling and operational processes. The introduction of these changes coupled with unusually favourable background external conditions have resulted in improved accuracy of our forecasts during 2013/14.

The current incentive regime provides an equal weighting to performance accuracy over each of the four days included in scope (D-2 to D-5). We welcome further consultation on whether this current weighting balance is most appropriate to support our customers' requirements.

Under the current scheme all elements of NTS demand are included within the scope of our forecast, including elements of demand, which are more unpredictable due to their reactive nature to factors such as; renewable forms of power generation, and commercial price differentials with no subsequent volatility adjustment mechanism<sup>1</sup> included. As a direct result, the more volatile elements are included within the scope of the overall demand forecast. We would be keen to understand customer views on whether all demand components provide value in supporting their ability to balance portfolios and whether separate forecasting processes on these components would provide additional value.

As we move through the RIIO T1 period, volatility of supply and demand is expected to increase and our ability to forecast and set up the network optimally will become more challenging. To maintain and enhance our forecast accuracy we will continue to develop our forecasting capabilities and processes and believe that any future incentive structure should support this.

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<sup>1</sup>A volatility adjuster is in place on the D-1 Demand Forecast incentive, which increases the incentive target by 0.038mcm/day per each mcm/day of additional fast cycle storage injection capability that comes on line.

## **Section 3 – Maintenance**

As defined in the consultation, we are required to carry out maintenance of network assets on the national transmission system (NTS) in order to ensure safety and security of the network and to ensure that the network can be operated economically and efficiently. During the RIIO T1 incentive engagement period our stakeholders asked us to improve flexibility to respond to customer requests, improve communications on planned maintenance and minimise disruption, by aligning outages with customer requirements. As a result, we have responded by undertaking a number of process and organisational changes.

An enhanced engagement process with our customers has helped us to assess maintenance activities against customer outage plans and as a result we have been able to bundle together a number of maintenance activities to support minimising the impact of our work on customers.

We publish a maintenance programme in line with the Uniform Network Code to provide notice to NTS customers of maintenance periods. Where a formal Maintenance Day is called we are permitted to undertake maintenance for the full duration of the day. In reality the impact of our activities on customer supplies will only take a small portion of this period.

Routine maintenance activities within scope of the incentive include In-line inspections and Remote valve operations for which appropriate performance standards have been identified. We are reviewing the other elements of our maintenance and NTS development activities which have impact on the capability of the network to assess the appropriateness of possible inclusion within scope of any future incentive.

## **Section 4 – Greenhouse Gas Emissions**

The current System Operator incentive seeks to minimise the release of gas from compressors and their associated pipe work wherever economical and operational decisions permit. The incentive is structured as a downside only incentive against an initial target level set at 2917 tonnes per annum for 2013/14, which reduces by 3% for each year of the next two incentive years. As a downside only scheme, the current incentive does not align to the proposed assessment criteria in offering potential for reward and penalty. We therefore believe that any future incentive structure should look to address this.

Venting levels are significantly affected by activities that are required to meet safety and environmental legislation. A substantial baseline level of compressor venting is directly associated with these activities and any future emission allowances should recognise this. To control and minimise the extent of gas release, options need to be considered, optimising between safety, operational, capital and environmental costs. As a prudent system operator, we look to appropriately balance all these factors as part of our ongoing activities.

A scheme of works was introduced as a special licence condition (C28, which became 8D) to undertake a detailed review of specific asset venting characteristics. The intention was that this scope of work would support assessment of the scale, scope and potential for future investment decisions to minimise emissions and be used to drive future SO incentive structures.

As part of the agreed scheme of works, a number of concerns have been highlighted on the potential level of fugitive emissions on assets in comparison to baseline expectations. The level estimated during this work challenges many international investment assumptions of other operators. Development of appropriate measures is expected to require a significant degree of research and innovation to achieve clarity on both the volumes of emissions and ways to cost effectively mitigate

these. We therefore feel that it is inappropriate for this area of emissions to be considered in any new incentive structure at this time.

In addition, reporting on emissions related to our Pipeline maintenance activities was introduced as part of the scheme. The varying characteristics of pipeline assets create a major challenge to the analysis and definition of appropriate baseline assumptions on levels of emissions. We continue to build up our capabilities to monitor, review and capture levels of emissions from this activity, including use of recompression equipment where possible.

We are committed to reducing National Grid group target carbon emissions and will continue to explore a mix of asset solutions, operational processes and utilisation of innovation programmes to reduce emission levels on our assets.

### ***Further information***

In a number of areas in our response, we have expressed an interest in views from our customer and stakeholders on the structure of these current incentive schemes. We welcome discussion on any of the incentives in scope of this review and look forward to further industry engagement. If you would like to discuss any aspect of this response and the forthcoming review process please contact David Wildash (David.Wildash@nationalgrid.com) or Richard Griffiths (Richard.Griffiths@nationalgrid.com). Alternatively, further details on our incentives can be accessed via the National Grid website address; <http://www2.nationalgrid.com/uk/Industry-information/gas-system-operator-incentives/>

Yours sincerely,

[by email]

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Gas Incentives Development Manager