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Dear Simon

NGC System Operator incentive scheme from April 2005 – initial proposals

Thank you for the opportunity to respond to this consultation on the initial proposals for National Grid's (NGC's) System Operator (SO) incentives scheme to apply from April 2005.

In the past economic regulation of SO operations has been an area where the dominating factor driving past decisions has been the huge information asymmetry that NGC enjoys, which has enabled NGC to profit maximise under the parameters of agreed schemes. That said, whilst there may be a question about the distribution of benefits under past schemes, the overall approach to SO incentivisation adopted in England and Wales by Ofgem is one that has over time shown demonstrable cost reduction to the benefit of consumers and that has created incentives that have had an observable and beneficial effect on the way NGC manages this key aspect of its business.

Against this background ConocoPhillips has some general comments and concerns regarding the proposals as outlined.

- profit levels earned by NGC have generally increased significantly under NETA relative to earlier schemes though NGC's risk is no greater. NGC has more options available to it now through the Balancing Mechanism, new balancing services and energy trades and its reward should generally be lower.
- a comparison of NGC's forecast outturn for 2004/05, and its actual outturn costs in previous years, clearly indicates that NGC has again overstated its forecast. Ofgem needs to set a more demanding target for the coming scheme based on the evidence of NGC's actual performance on SO costs to date, and recognise the fact that NGC would seem to consistently overstate its cost projections.

- in setting a SO Incentive Scheme target for 2005/06, it is likely that a value significant lower than that implied by the NGC scenarios should be used. If one were to believe and use NGC's scenarios as the starting basis for setting the target, one might consider using their mean value or their mode value as a starting point. However, as NGC continuously outperforms its target, an adjustment could be made based on past performance. The adjustment could be the average of all three years or it could be simply based on the current expectation for 2004/05 scaled up to accommodate Scotland.
- there remains a lack of transparency regarding how NGC incurs SO costs, and the main drivers of its performance, which prevents grid users who pay the costs understanding fully how NGC is performing against target within appropriate timescales. Most information on performance is made available well after the end of the financial year in question, and usually only to a high level of reporting. The current consultation shows very limited analysis of past performance.
- The issue of information disclosure is very important to market participants. NGC should be obliged as a minimum to provide:
 - 1) a range of charts for total IBC and component costs such as CSOBM providing year on year comparisons at monthly or (ideally) weekly resolution;
 - 2) a clear high level explanation of why costs behaved as they did (not merely a report of what they did). In addition NGC could use the drivers it uses to construct its forecast scenarios to explain past behavior; and
 - 3) a tabular comparison of previous incentivised years (2001/02, 2002/03, 2003/04, 2004/05 to date) using the scenario drivers and/or other explanatory factors.

With regard to the detailed questions and proposals canvassed by Ofgem, we generally agree with the proposals with one caveat, that sharing factors and caps and collars should be symmetrical.

Please let me know whether you have any comments or queries.

Yours sincerely,



Rekha Patel
Gas and Power Regulatory Analyst