



*taking care of the essentials*

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Our Ref.  
Your Ref.  
11th March 2005

Dear Sonia,

**Initial thoughts on enduring incentive schemes supporting the offtake arrangements**

British Gas welcomes the opportunity to provide comments to Ofgem on the above initial thoughts publication.

Although we share the concerns expressed through the industry workstreams on the proposed reforms of the Exit regime, we would like to offer the following comments based on the business rules as proposed:

**Baselines**

Through price controls to date, Transco have been properly funded to provide and operate the system that currently exists. At the very least, the current system operates to 1:20 standard and in most cases will actually exceed this. We therefore suggest that the baselines should be based on the current practical physical capabilities of the system as it now exists. To do otherwise, would allow Transco to achieve the incentives without any effort or investment. This principle should apply to both capacity and Flow Flexibility baselines. We are concerned that there have been no published indicative Flow Flexibility baseline figures.

We are unsure on how some of the indicative capacity baseline figures have been calculated, as there seem to be a number of large inconsistencies. This is especially in regard to the theoretical maximum physical baselines that are lower than the Firm and Interruptible baselines.

On a further point, section 4.19 states that Entry baseline are based on the theoretical maximum physical capabilities, however, we suggest this should read that the Entry baselines are based on 90% of the theoretical maximum physical capabilities allowing for interaction of entry flows.

**Interaction of Products**

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Any enhancement of the system, which in the main would be additional pipeline or additional compression, is likely to deliver a number of differing benefits. The physical capacity of the system will increase, which will affect both Entry and Exit capability. Linepack (or Flow Flexibility) will also be increased. We have difficulty understanding how the benefits of any one investment project will be apportioned to each of these products and also how the industry can be sure that no double counting of benefits has occurred. With this uncertainty, there is much scope for distortion between the incentives and the performance against them. We do not believe there should be scope to earn multiple incentive payments from signals emanating from both Entry and Exit allocation processes by a single investment. We suggest that full transparency in this area is paramount to an effective scheme.

### Pricing

We note that as we haven't seen how either entry capacity or Flow Flexibility will actually be priced, it is difficult to pass the correct judgement on the incentives and to determine if they will work in practise.

Capacity - We believe that the calculation of the exchange rates is critical to the scheme. These rates should be inversely related to the costs, otherwise, we believe they could be open to abuse, by purchases at a less expensive location, being traded for a more expensive location.

Additionally, we also have concerns over the long term relocation of capacity between nodes by Transco due to excess bids at one node. If this is limited to one year's revenue, it should incentivise Transco to build where there is a sustained demand.

Flow Flexibility - We suggest that it will be difficult to calculate a value for Flow Flexibility in the longer term. In addition, we believe the flow flexibility business rules are complicated.

### Investment Signals

We are concerned that any allocation process will be insufficient at providing signals for investment. We believe that most user/customer relationships will be of a short term nature and it is unlikely that there could be sufficient certainty in eight (or fifteen) years ahead to support a financial commitment. These arrangements would be dependent on the contractual agreements between users and their customers.

We suggest the existence of a parallel planning process is essential, as has proved to be the case for Entry.

### Aims of Incentives

NTS - We believe that the practical capabilities of the system should be delivered on the basis of a standard investment return, only where the system has been enhanced should an incentive be available

It is essential that any driver for incremental capability or enhancement must carry balanced incentives of risk and reward equitably shared by both Transporters and Users.

We believe a 6.25% rate of return is appropriate as the standard cost of capital is applied. We do not believe that there will be a sustained demand for long term investment requiring a higher rate of return. We further support a 50% sharing factor is appropriate as long as it

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is a reward for real enhancement rather than an exploitation of spare capacity inherent in the system.

DNs -

We do not believe that the DN incentive scheme can be fully developed until the enduring interruption arrangements have been finalised. Furthermore, we do not believe that illustrative numbers should or can be used for any analysis of effect.

Notwithstanding, we suggest that a 1:20 arrangement should be the minimum acceptable obligation. It is also essential that equitable upside and downside sharing factors are developed in relation to over or under booking of NTS capacity and flow flexibility. This is to ensure that DN owners are appropriately exposed to the costs of booking incorrect volumes of capacity and these costs are not just passed onto users.

We suggest both the NTS and DN incentive regimes should be fixed for 5 years and should run concurrently.

Please contact me if you have any queries regarding these comments.

Yours sincerely,

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