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Dear Sonia

**Potential sale of gas distribution network businesses – initial thoughts on enduring incentive schemes supporting the offtake arrangements**

I provide below the principal issues that our consortium wishes to raise on this initial consultation.

**Enduring incentives**

We support the statement that the enduring incentive scheme should be reopened within (a maximum of) one year from September 2005. There may be some merit in linking any such review to the reform of interruption arrangements planned for implementation in April 2006 if sufficient information is available from the initial months operation of the incentive scheme.

**Baseline Calculation**

The exit capacity and flow flexibility baselines are key to any incentive framework operating correctly. Baselines must be realistically capable of being satisfied (on any day) such that capacity levels can be ordinarily delivered. The appropriateness of such baselines should ensure no perverse incentives govern the decision making process – if the baseline is too lax or too tough, capacity provision (and incentive benefits) may be driven by behaviour other than that anticipated to correctly utilise the options available to all parties to satisfy capacity demand. Our view is that baselines should be set at the Practical Maximum Physical capability. We have not yet had the opportunity to verify the accuracy of the values set out in appendix 1.

It is important that baselines reflect changes in demand and therefore they should increase over time as demand grows and not remain as a constant.

## **Maintenance linked to NTS Incentives**

The (current) draft DN Operator arrangements provide significant power to the NTS in terms of being the ultimate decision maker in terms of determining each DN's Maintenance schedule (IDNs are seeking to limit these controls in the DN Operator Agreement discussions). We would welcome any collaborative approach, which went some way to redress the current balance.

## **DN Sharing Factor (SF)**

The suitability of the proposed 100% DN SF needs to be judged against the following:

- a) the breadth of the proposed cap and collar; and
- b) certainty as to the DN incentive targets.

Only on publication of these two components can a Transporter adequately assess whether such an incentive framework provides an appropriate risk and reward framework. Given the potential range of DN incentive targets (as illustrated by table 4.2) it would appear prudent to limit the incentive values until more robust data is available post September 2005. However, the incentives must be symmetrical to provide the appropriate balance between transporters and customers.

## **Linking DN investment to incentives**

Including investment within incentive parameters would, we believe, be overly complex to apply. Consequently, our preference is for the approach given in 4.73 whereby the incentive would give DNs sufficient gross incentive revenue to incentivise DNs to invest or not invest in NTS offtake related investments. This will be more transparent and would not require the identification of investments on an ongoing basis.

## **Demand growth**

The manner in which demand growth in a DN is measured should be measured *ex ante* so as to provide more certainty to the DN and also to provide a much simpler methodology.

If you wish to discuss any of the points contained in our response please do not hesitate to give me a call.

Yours sincerely



Alex Wiseman  
Gas Regulation Director