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19 October 2005

Dear Mark

Initial proposals on transitional incentive schemes supporting the offtake arrangements

Please find attached a copy of the National Grid NTS response to Ofgem's proposals on transitional incentive schemes supporting the offtake arrangements.

In the meantime, if you require any further assistance, please do not hesitate to contact me.

Yours sincerely

By e-mail

Chris Bennett
Regulation Transmission Manager

National Grid NTS response to Ofgem's initial proposals on transitional incentive schemes supporting the offtake arrangements

Introduction

We welcome the opportunity to respond to Ofgem's initial proposals on the transitional incentive schemes supporting the offtake arrangements. This response is written on behalf of National Grid National Transmission System (NTS).

Our response provides comments on the specific questions upon which Ofgem has invited views and is structured into those relevant to the NTS incentives and those that apply to the DN incentives.

NTS incentives

We agree that the NTS transitional incentives should be considered as part of the next price control review, as we believe there is a need to look at all the interactions between entry and exit. This will enable incentives to be set in the context of the wider price control agreement and allow the most appropriate methodology to setting output measures (such as baselines) and Unit Cost Allowances to be determined. We are particularly keen to ensure that the process of setting baselines and revenue drivers leads to any costs that we may incur for providing increased entry, exit, flat or flexibility capacity being appropriately remunerated.

Ofgem states that one risk from not setting the NTS incentives at this time would be that "the NTS makes inefficient decisions", in that "Transco NTS may simply choose to invest in pipelines rather than choosing to deliver capacity through more efficient network management". We do not believe that this would be the case, as our wider licence obligations such as those within Standard Special Condition A11 (relating to efficient and economic operation of the system) would still apply.

DN incentives

We believe that the scope of the DN incentives is broadly correct and that it is appropriate for Ofgem to set the DN incentives now in view of the investment lead times involved for the NTS. As part of the overall package associated with the transitional arrangements, we continue to support the need for an ARCA on the DN in order to provide a level of financial commitment to underpin any specific reinforcement that the NTS would need to undertake to deliver the requested incremental capacity. Under such a regime, we would agree with Ofgem's statement that DNs should not be able to pass through the costs of penalty payments made under any ARCA commitment to their customers.

In relation to the proposed definition of caps, collars and sharing factors in the DN transitional incentives schemes we note that the parameters (such as sharing factors and caps/collars) for the DN incentives schemes highlighted in Table 4.1 are in line with those proposed for the interim. Clearly it is for the DNs to decide whether they provide the correct risk and reward balance and therefore we make no comments on

the parameters themselves. As a matter of principle however, we would support a regime that provides an incentive on the DNs not to over-book NTS flat or flexibility offtake capacity. However, we also believe it is important that the DNs should be appropriately remunerated for booking their 1 in 20 requirements. Finally, in relation to the scope of the DN incentives, we can see the logic in Ofgem's view that the incentive around payments made for greater than 15-day interruption should form part of the reform of interruption arrangements on the DNs.

In relation to the question on reference prices, we agree that the most appropriate reference price for NTS offtake (flat) capacity remains the prevailing (outturn) price of NTS exit capacity as set out in our charging statement. As previously mentioned in our response to the interim incentive arrangements, we continue to have some concerns over the potential perverse incentives associated with a reference price for NTS offtake (flexibility) being based on the flat exit capacity charge. We would therefore support Ofgem's statements made in paragraph 4.23 regarding the fact that the methodology used to calculate the price of the NTS exit capacity is likely to be reviewed in the context of the forthcoming transmission price control review. We would also support Ofgem's view that it would be appropriate to include the resulting revised NTS offtake (flat) capacity and NTS offtake (flexibility) capacity charges in the calculation of the cost performance targets for the transitional incentive schemes rather than the current prices.

Finally we would welcome a discussion with Ofgem on the proposed timescales associated with developing the NTS transitional incentive arrangements as part of the transmission price control review.