

# Initial thoughts on enduring offtake arrangements and incentives

Mark Feather  
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# Background

- January 2005
  - Authority endorsed its previous decisions on framework necessary post DN sales
  - enduring offtake arrangements to be implemented by September 2005
- June 2005
  - Enduring offtake arrangements necessary to protect the interests of customers
  - Implementation delayed until September 2007
  - Work to be undertaken as part of TPCR
  - Interactions between entry and offtake regimes to be considered
  - Enables further consultation

## Objectives: enduring offtake arrangements

- Need to meet Authority principal objective and statutory/licence duties of National Grid Gas.
- The arrangements must therefore, amongst other things:
  - provide efficient investment signals to Transco NTS and promote efficient system operation on the NTS
  - enable access to offtake rights on a not unduly discriminatory basis; and
  - facilitate effective competition between shippers
  - as a consequence, better protect the interests of customers

# Enduring offtake arrangements

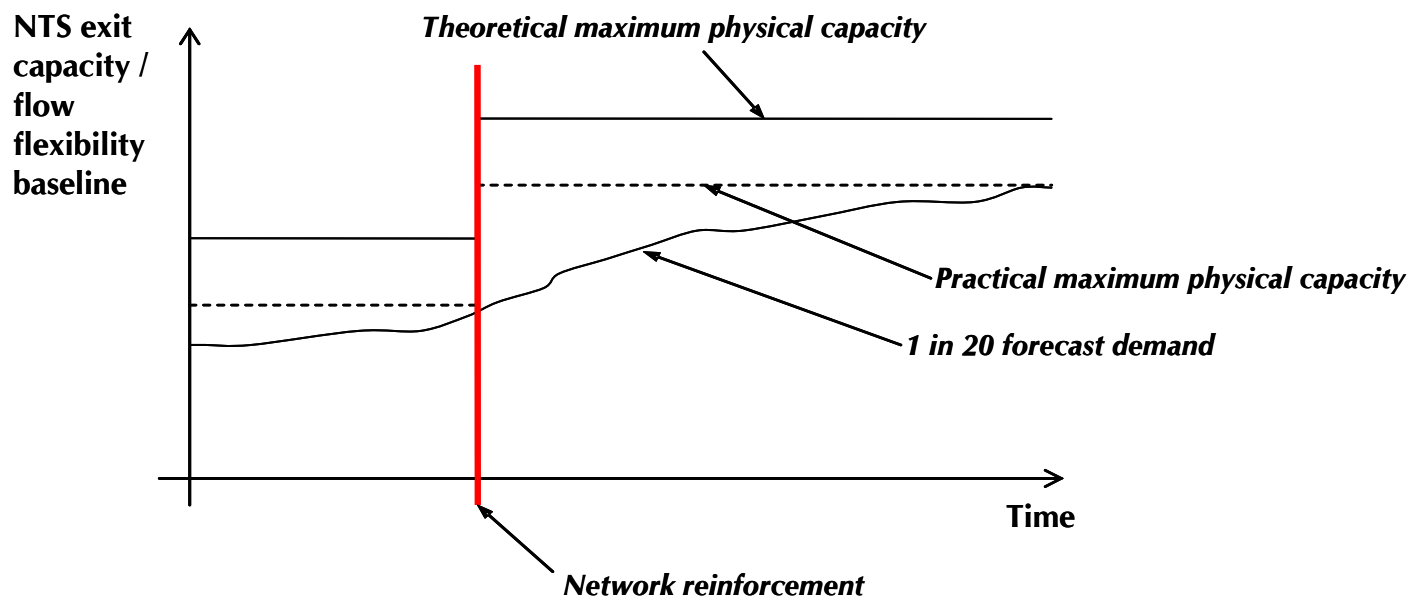
- Initial thoughts document outlined the proposed offtake arrangements
- Necessary to ensure no undue discrimination
- Consistent with Final IA
- Two products (flat capacity and flow flexibility) allocated on a non-discriminatory basis
- Issues:
  - spatial definition of product
  - determining quantity/outputs
  - pricing issues
  - entry-exit interactions

# Spatial definition of product

- Degree of disaggregation: nodal / zonal / global ?
- Initial thoughts document envisaged nodal definition of capacity rights
- However, level of substitutability between exit points should be explored – maximise capacity availability – avoid sterilisation of capacity.
- Experience of DN incentives
- Zonal model?
- Need also to consider potential for exchange rates between nodes/zones.

# Determining quantity/outputs

Three main options are presented below (for a given exit point/zone):



# Pricing issues

- Interaction of baseline definition with reserve prices
- Reserve prices set pursuant to NG Gas pricing methodology
- Main issues are:
  - Potential readjustment of exit capacity prices by NG Gas?
  - Methodology for price derivation
  - Determination of flex prices.

# Entry/exit interactions

- While approach undertaken in entry and exit regime may need to be different, issues are similar.
- Interactions between entry and exit regime need to be considered. For example:
  - should baseline methodologies at entry and exit be the same?
  - to what extent can investments be attributed to entry or exit?
  - how does investment impact quantities available?

# NTS Incentives

- Should meet following objectives:
  - Facilitate efficient investment in response to market signals
  - Efficient day to day system operation including constraint management and efficient use of available network
  - Promote efficient trade offs between investment and buy backs.
- Investment incentive
  - Duration? 5 year rolling incentive?
  - Use of NPV test?
  - Rate of return?

## NTS Incentives (2)

- Substitution incentive
  - Initial thoughts consulted on this incentive – mixed response received.
  - Too much discretion for National Grid Gas NTS?
  - Information asymmetries?
  - Necessary under a zonal model?
- Medium/short term incentives
  - ensure efficient constraint management and efficient use of existing capacity;
  - Duration of schemes?
  - Allocation of risk – sharing factors/caps and collars.

A large, central version of the ofgem logo is positioned in the middle of the slide. It features the word "ofgem" in white lowercase letters on a red rounded rectangular background. The background of the slide is a light blue gradient with a faint image of a power outlet and a person sitting at a desk.

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