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Dear Mr Feather

**Final proposals on transitional incentive schemes and formal licence consultation under section 23 of the Gas Act 1986 and paragraph 3(a) of Standard Special Condition A2**

**Comments**

energywatch welcomes the opportunity to provide comments on Ofgem's final proposals on the transitional incentive schemes to apply to gas distribution networks (DNs) and gas customers directly connected to National Grid's NTS, and the related licence changes required to implement the schemes.

In general, we continue to support incentive schemes for DNs which ensure that connecting networks deliver an efficient, cost effective and robust set of transportation arrangements which keep costs low for the end consumer. The proposed scheme should provide the relevant incentives and ensure that the external costs of operating the network are internalised and tied to the decisions made by DNs when seeking exit capacity from National Grid NTS, making them responsible for the financial repercussions of their requests for that capacity. We also reiterate that the off take arrangements should have non-discriminatory application, whether the request for capacity is made by DNs or by directly connected customers.

**Specific aspects of the final proposed incentive scheme**

energywatch agrees with Ofgem that the burden of costs for overbooking exit capacity should sit with the DN party making that request, and that the proposed incentives are intended to ensure that DNs undertake the appropriate demand forecasting and assessment of capacity requirement which should prevent the overbooking of exit rights.

We maintain our view, and agree with Ofgem, that the 'greater than 15 day' interruptions DN incentive should be reviewed alongside other aspects of the DN interruptions regime in 2007 and that extending the incentive now for the transitional arrangements period beginning on 1 October 2008 would be

inappropriate. A holistic approach to the determination of incentives required in this respect is more efficient from a process and substantive point of view.

We note the responses of some DNs regarding the bilateral advanced reservation of capacity agreements (ARCAs) which they would maintain with National Grid NTS in the circumstances where network reinforcement is required to boost capacity, and the view that these may impose a 'double penalty' on them for overbooking capacity. However, our view is that the incentives scheme and the ARCAs are designed to maintain appropriate signals to DNs regarding the advanced booking of capacity. Ofgem has already signalled that its role under the ARCAs is limited to providing dispute resolution for the parties to an ARCA given the bilateral nature of these agreements. The DNs should be in a position to bilaterally establish arrangements for capacity with National Grid NTS which prevent inefficient investment on the NTS and reduce the risk of stranded assets, leading to an efficiently operated system.

energywatch notes that the final proposed transitional incentive scheme remains in a form (a 'sliding scale' structure of defined cost target, cap and collar) which we consider appropriate and in tune with the current interim incentive scheme. We believe that this form of scheme is best capable of delivering cost effective and efficient off take arrangements which are necessary for keeping costs low for end consumers. We acknowledge that there are concerns amongst DNs regarding the potential financial exposure arising from price risks and that the absolute limits of +/- £5million set in the cap and collar are sufficiently high to meet these concerns whilst continuing to provide appropriate incentives for efficient off take.

We also note that there are separate arrangements for DNs to raise Income Adjusting Event applications if necessary where they believe that there has been exposure to unforeseen costs. We will be responding to the consultation on this issue separately but believe that this provides DNs with another option to deal with the issue of price risk which should not prevent them from meeting their obligations to operate in an efficient and economic manner when making off take capacity decisions in the transitional period.

We support Ofgem's view that the appropriate scope and form of NTS incentives for the transitional period are left to wider and holistic consideration through the Transmission Price Control Review (TPCR) in 2007, when some further experience of NTS incentives under the interim scheme will have accrued, informing the proposed incentive scheme at the time of the TPCR. We are disappointed that Ofgem does not consider our suggestion of a 'shadow NTS off take incentive scheme' to be helpful, as we believe that this would provide further useful evidence upon which to base the NTS incentives to be developed in the longer term. The absence of financial incentives should not necessarily create distortions in the actions of parties in terms of their off take arrangements during the interim scheme period.

energywatch notes the linkage between the licence modifications in the final proposals and the related modification proposal UNC0046. We recognise that Ofgem would also like to consider National Grid NTS's final report on Incremental Exit Capacity Release (IExCR) prior to determining whether to approve UNC0046. We continue to believe that, with the implementation of UNC0046, and if the evidence suggests that the interim and transitional offtake arrangements are operating satisfactorily, there should be no need for an enduring set of offtake arrangements. We note that Ofgem intends to create an Enduring Offtake Working

Group to consider the issues surrounding exit capacity and would be happy to provide input to its discussions.

### **The proposed licence modifications**

We believe that the licence modifications to the various GT licences are 'fit for purpose' in order to apply the final proposals for a transitional incentive scheme and have no further comment on the detail of the modifications.

If you do wish to discuss our response further please do not hesitate to contact me on 0191 2212072.

Yours sincerely

Carole Pitkeathley  
Head of Regulatory Affairs