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Dear Lewis

Re: Ofgem consultation “Reform of interruption arrangements on gas distribution networks – An update”

We welcome the opportunity to respond to Ofgem’s consultation on “Reform of interruption arrangements on gas distribution networks – An update”. This response is written on behalf of National Grid Gas plc in its capacity as the holder of a Gas Transporter Licence in respect of the National Transmission System (“National Grid Gas NTS”).

Executive Summary

We support Ofgem’s desire to reform the current DN interruption arrangements to allow GDNs the choice to decide whether they require interruptible services and to encourage users to provide better long term signals in respect of their need for investment in distribution network capacity. However, we consider that such reforms must be compatible with the development of the enduring NTS offtake arrangements, but recognise the uncertainty of such arrangements until an Authority decision has been made on UNC Modification Proposal 0116V and the alternate proposals. In particular, we note the important interaction of setting DN incentives to ensure the right balance between investments and use of interruptible services across both transmission and distribution networks. Our response therefore focuses on this element of Ofgem’s consultation; our views are summarised below:

- We support option 1, a sliding scale incentive, in preference to the other 2 options, as it could provide a degree of protection to costs beyond the GDNs control and is based on actual as opposed to benchmark costs;
- We have concerns over the setting of only a one year incentive as this would prevent the provision of efficient investment signals for flat capacity to National Grid Gas NTS or efficient booking of flex capacity under the enduring NTS offtake arrangements beyond Gas Year 2010/11, as allowed under UNC Modification Proposal 0116V in July 2007, if such a proposal is implemented.

Chapter 3. GDN Incentives

Question 1. Which of the options proposed by Ofgem for setting a one year incentives for the GDNs purchases of interruption and NTS offtake capacity do respondents support and why?

We note that Ofgem has proposed 3 options to incentivise GDNs to purchase interruption and NTS exit capacity efficiently following reform of LDZ interruption and NTS offtake arrangements from October 2010; 1) specific incentives with caps, collars and sharing factors, 2) an allowance within an RPI-X price control and 3) cost target incentive for the GDNs related to a benchmark level of costs with the actual costs being passed through to customers.

In principle, we consider that a specific incentive should be set based on the actual costs of interruption on the distribution network and purchase of NTS Exit Capacity (option 1). This would encourage GDNs to consider the most efficient and economic contracting strategy, while providing a degree of protection through appropriate setting of caps and collars under the incentive regime from costs beyond its control. In particular we consider that the use of actual costs as opposed to benchmarks (as proposed under option 3) should be applied under such incentives to ensure that, from an enduring NTS offtake arrangements perspective, GDNs and shippers are both exposed to the prices that National Grid Gas NTS set for NTS Exit Capacity. This would support, as best possible, the common treatment of NTS Exit Users.

In addition, we note that the current arrangements in respect of the transitional exit regime do not apply to short term purchases of NTS offtake capacity. This includes both day ahead and on the day capacity releases. This arrangement could lead to DN's under-booking their long term capacity requirements and paying effectively a lower price than that which would reflect the cost should explicit investments be required to support such capacity provision. We look forward to further details being provided in respect of how the proposed DN incentive arrangements will deal with such issues.

Question 2. What are respondents views on the factors that should determine the level at which interruptions and NTS exit capacity incentives are set?

We consider that the NTS Exit Capacity incentive should consider both historic bookings and actual utilisation of NTS Exit (Flat) Capacity and NTS Exit (Flex) Capacity. We note that the setting of the price element of such incentive arrangement is potentially more difficult and depends on the outcome of the enduring NTS offtake arrangements in respect of the nature and form of the User Commitment and associated charging methodologies, which is not expected until after Authority decision on UNC Modification Proposal 0116V and the alternates.

Question 3. Do respondents agree with Ofgem's proposal to set a one year incentive for GDN's purchases on interruption and NTS offtake capacity from October 2010 and longer term incentives as part of the GDPCR?

In the event that UNC Modification Proposal 0116V, 0116BV, 0116CV or 0116VD is implemented reforming the NTS offtake arrangements, GDNs will have the ability to purchase NTS Exit (Flat) Capacity in July 2007 for use from Gas Year 2010/11, 2011/12 and/or 2012/13. In addition, GDNs will have the ability to purchase NTS Exit (Flex) Capacity in July 2007 via auctions for use in Gas Year 2010/11 and/or 2011/12 (except for 0116CV).

The setting of only a one year incentive for GDNs prior to July 07 would therefore not cover the full period over which GDNs would be able to purchase NTS Exit Capacity. This inconsistency may discourage GDNs from providing investment signals to National Grid Gas NTS in the absence of certainty of such incentive arrangements, or result in inefficient signals. For such reasons, Ofgem has previously indicated that it considers that GDNs should only be able to purchase NTS Exit Capacity once incentive arrangements have been implemented. In addition, we consider that the setting of a one year incentive is inconsistent with Ofgem's proposals for User Commitments to be obtained by National Grid Gas NTS to underpin its investments whereby GDNs (and shippers) would be committing to NTS Exit Capacity for a number of Gas Years beyond 2010/11.

We also note that Ofgem proposes the continuation of the GDN interruption incentive over the transitional period up to 30 September 2010. We support such a proposal, consistent with our response to the same issue raised as part of the Transmission Price Control review. However we note that Ofgem's Final Proposals in respect of the Transmission Price Control Review propose that the interruption incentive should cease at the end of the "interim arrangements" i.e. after 30 September 2008.

Please do not hesitate to contact either me or Paul Roberts on 01926 656369 if you wish to discuss our response.

Yours sincerely

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