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Dear Lewis,

Response to consultation on NTS Exit capacity and interruption incentive for Gas Distribution Networks 2010/11

Thank you for the opportunity to respond to the Ofgem consultation on the NTS Exit Capacity and interruption incentive for Gas Distribution Networks 2010/11. This response is sent on behalf of National Grid's distribution business.

Regarding the proposed incentive arrangements we agree that:

1. they should be based on an extension of the existing incentive framework as we see no reason to change those arrangements that have been in operation since network sales
2. it is sensible that the flat and flex targets are based on our BPQ submission as these provide realistic estimates of planned capacity requirements
3. the threshold to trigger an Income Adjustment Event (IAE) should be set at £1m as this is in line with the present arrangements

However, we believe that it is inappropriate to set the target for the greater than 15 day interruption target to zero. Incentive schemes should be designed to offer a reward to companies if they are successful in managing down the costs associated with a particular activity as well as penalising poor performance. In this case there is clearly a risk that, notwithstanding the recent mild winters, cold weather will expose Gas Transporters to costs associated with greater than 15 days interruption, but there would be no countervailing possibility of any gain. For the scheme to be fair, this risk should either be offset by a positive allowance in the incentive scheme or, if Ofgem believe that the risks are negligible, removed by allowing transporters to "pass through" all the costs. The fact that Ofgem are proposing to retain a collar of £5m tends to suggest a belief that the risk is significant and a positive target should be proposed accordingly.

We do not accept the argument that "when the transitional offtake incentive arrangements were implemented in January 2006 the allowance for GDNs interruption payments to customers was set to zero". Ofgem's final proposals on transitional incentive schemes published in November 2005 states that "Ofgem does not consider it appropriate to extend all the incentive schemes currently applying to National Grid NTS and the DNs into the transitional period at this time: the "greater than 15 day interruptions" DN incentive will be reviewed as part of the DN interruptions reform project." In the same consultation Ofgem also stated that it "considers that a delay would make available a better quality data set against which to determine an incentive. As such, and given the forthcoming DN interruptions reform, Ofgem considers that the deferral of this element of the scheme until that time is appropriate". These statements make it clear that Ofgem had yet to make a decision. The setting to

zero of the incentive must therefore represent the fact that no targets had yet been set and not a decision to implement zero as the appropriate target.

This position is supported by Ofgem's October 2006 consultation on the Reform of interruption arrangements on gas distribution networks – An update¹ where it stated that "There are currently no interruption incentives in place for the period 1 October 2008 to 30 September 2010 (known as the transitional period for NTS offtake reform). Ofgem will set an interruption incentive for this period leading up to 1 October 2010 when it is anticipated that the reformed interruption arrangements will begin."

Now that there is clarity about GDN interruption reform it would appear appropriate for Ofgem to set the incentives. Furthermore, we believe that the target should be set in line with our present targets. The proposed interruption reform is to be implemented on 1 April 2008 with interruptible contracts taking effect from October 2011. The incentive arrangements for 2011 onwards will be taken forward as part of the GDPCR process but because the transition arrangements (2008-2011) are essentially an extension of the present arrangements we feel the incentives should reflect this.

Finally, we would like to record that the proposed timescales with regard to publishing the Final Proposals on the 2010/11 gas year exit capacity and interruption incentives (June 2007) and statutory licence modification consultation (June-July 2007) allow only the minimum time for GDNs to perform their analysis and make their capacity bookings in June/July 2007. Any delay in this process will jeopardise the GDN's ability to complete this analysis and make appropriate capacity bookings.

If you have any queries, or would like to discuss this response, please do not hesitate to contact me.

Yours sincerely,

Mark Freeman

¹ Reform of interruption arrangements on gas distribution networks – An update, 19/10/06, October 2006