National Grid Gas NTS and other
interested parties

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26 November 2009

Dear Colleague

Notice under section 23(3) of the Gas Act - Proposed modification of National Grid Gas Plc's National Transmission System Gas Transporter Licence with respect to entry capacity operational buy-back incentive and default incremental entry capacity lead time

This letter sets out proposed modifications to the entry capacity operational buy-back incentive and to the default incremental entry capacity lead time.

Having regard to the principal objective and statutory duties[1] of the Authority[2] and for the reasons set out in this letter, the Authority has decided that it will[3]:

- reduce the entry capacity operational buy-back target from £21 million to £13.5 million, effective from 1 January 2010;
- reduce the entry capacity operational buy-back upside cap[4] from £18 million to £13.5 million, effective from 1 January 2010;
- reduce the entry capacity operational buy-back downside collar[5] from £18 million to £10 million, effective from 1 January 2010; and
- defer review of the default incremental entry capacity lead time until the next full transmission price control review.

This letter outlines:

- the background to the issues;
- the proposals set out in our consultation of 25 February 2009 and the responses we received to this consultation (including updated analysis from National Grid Gas (NGG)); and
- our views and the detailed reasons for our decision, which inform proposed modifications to Special Condition C8D(3) of NGG National Transmission System (NTS) Gas Transporter Licence.

[1] Set out in Section 4AA of the Gas Act 1986, as amended.
[2] Ofgem is the Office of the Gas and Electricity Markets Authority, The terms 'Ofgem', 'the Authority' and 'We' are used interchangeably in this letter.
[3] As the parameters are being modified midway through the 2009/10 formula year we have calculated a transitional figure weighted by the number of months in the licence.
[4] The 'cap' is the maximum amount that National Grid Gas's (NGG) revenues can increase from the entry capacity operational buy-back incentive.
[5] The 'collar' is the maximum amount that NGG's revenues can decrease from the entry capacity operational buy-back incentive.

The proposed licence modifications and associated statutory consultation are included in a Notice under section 23 of the Gas Act 1986 which accompanies this letter. The consultation is open until 24 December 2009.

Background

Entry capacity operational buy-back incentive

NGG is obligated to offer for sale certain amounts of firm non-incremental entry capacity at each entry point to the NTS, as specified in the licence; these amounts are referred to as 'baselines'. NGG offers this firm capacity for sale through a series of auctions. In the Quarterly System Entry Capacity (QSEC) auctions, if user-commitment signals the need for capacity which exceeds the baseline, NGG can release the additional capacity as incremental entry capacity.

When operating the NTS, NGG may find itself in a position where it cannot meet the capacity obligations it has previously sold. In such a situation, NGG may buy back some of that capacity.

Where NGG receives a signal for incremental entry capacity (and capacity has not been substituted[6] from other entry points to meet the incremental request), NGG's allowed revenues will automatically increase. NGG has two main options to deliver this incremental entry capacity. It can:

- invest to increase NTS capability – this results in increased capex costs but reduces the likelihood that NGG will have to buy-back capacity to meet its obligations; or
- accommodate the increased obligations by better utilising the existing network – this saves on capex costs but results in a greater risk of having to buy-back capacity.

The entry capacity operational buy-back incentive allows NGG to increase its System Operator (SO) revenue if it can contain the costs of buy-back of entry capacity[7]. However, if NGG incurs high entry capacity buy-back costs, then, other things being equal, the entry capacity operational buy-back incentive acts to reduce SO revenue.

In practice, the amount that NGG earns from the incentive is determined by how NGG performs against a defined performance measure. The performance measure is calculated from the costs of entry capacity buy-back less revenues from the sale of certain entry capacity products[8], amongst other things[9]. If NGG's performance matches the target level for the incentive it does not earn any revenue from the incentive. If NGG outperforms the incentive then it earns 50% (the sharing factor) of the difference between the target and the value of the performance measure, subject to a limit of £18 million (the cap). If NGG underperforms against the target then its revenue is effectively decreased by 50% of the difference between the target and the value of the performance measure, subject to a limit of £18 million (the collar).

At TPCR4, Ofgem modified NGG's entry capacity buy-back incentive which had previously applied to both incremental and existing entry capacity. We introduced two main changes:

- First, the existing incentive was split into two separate incentives, one for incremental entry capacity (signalled after 31 March 2007 until that capacity is delivered) and another for all other 'operational' entry capacity.

[6] Entry capacity substitution is the process by which unsold entry capacity is moved from one or more entry points to meet demand for incremental entry capacity at another entry point.
[7] Other than buy-back of incremental entry capacity signalled after 31 March 2007, until it has been delivered.
[8] This includes revenue from the sale of on-the-day obligated entry capacity, interruptible entry capacity, non-obligated entry capacity and incremental obligated entry capacity that has been released on an accelerated timescale.
[9] This includes revenue from entry overrun charges, revenue from locational sell actions and physical renomination incentive charges.

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- Second, we modified some of the parameters of the entry capacity operational buy-back incentive.

However, in the final TPCR4 proposals we decided not to make all of the changes to the incentive that we had suggested previously. This was because there was some uncertainty regarding future buy-back prices and volumes. We decided to review and potentially reset the parameters of the operational buy-back incentive after two years.

In May 2008, prior to completing the 'buy-back' review we concluded a separate review of baselines, which resulted in a slight increase in baseline levels at a number of entry points. We also concluded that there should be a consequential increase in the entry capacity operational buy-back incentive target from £18 million to £21 million. In making the latter decision we were mindful of the need to preserve the integrity of the TPCR4 settlement and, in particular, the need to leave the settlement intact, pending the completion of our planned review of the buy-back incentive. As a consequence, during our review of baselines, we did not use information on actual and estimated buy-back costs which would not have been available to us at the time of TPCR4. We noted in the Section 38A Notice[10] which modified NGG's licence to reflect TPCR4 that if we adjusted the entry capacity operational buy-back incentive purely as a result of the review of baselines, we would still review and potentially reset the parameters of the incentive as we had intended to do two years after TPCR4.

Default incremental entry capacity lead time

The default incremental entry capacity lead time is the time between the receipt of a signal from an auction and when NGG is contractually obligated to deliver the relevant capacity. At TPCR4, we set the default incremental entry capacity lead time to 42 months. NGG had argued during TPCR4 for a 48 month default incremental entry capacity lead time. However, we were not persuaded by the evidence that NGG presented at that time and therefore stated our intention to review the default incremental entry capacity lead times at the same time as the entry capacity operational buy-back incentive.

Consultation

As part of our review of the entry capacity operational buy-back incentive and of the default incremental entry capacity lead time, we issued a consultation paper[11] which was published on 25 February 2009. We have carefully considered the views expressed by respondents to the consultation, which can be viewed on the Ofgem website[12]. We have subsequently received and considered an update of the buy-back analysis submitted by NGG.

Entry capacity operational buy-back incentive

In our February consultation we set out four options; these were:

- Option 1 – change the cap and collar
- Option 2 – change the sharing factor
- Option 3 – change the target
- Option 4 – leave the parameters as they are i.e. 'do nothing'

Our preferred approach was to adopt option 3. We proposed to reduce the target level of the incentive to a figure in the range of £12.4 million to £13 million. This is because:

- buy-back costs in 2008/9 were estimated to be between £12.4 million to £13 million in late 2007 and in early 2008 and we expected them to fall by 2011/12
- we considered that NGG has a history of outperforming this incentive, and

[10] See 'Section 38A notice in respect of reasons for the decision to modify the licence of National Grid Gas plc' 5 September 2007, with reference number 217/07, on Ofgem website www.ofgem.gov.uk.
[11] See 'Review of entry capacity operational buy-back incentive and default incremental entry capacity lead time', 25 February 2009, with reference number 11/09, on Ofgem website www.ofgem.gov.uk.
[12] See page on Ofgem website, www.ofgem.gov.uk, with link to 'Review of entry capacity operational buy-back incentive and default incremental entry capacity lead time', 25 February 2009, with reference number 11/09.

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- we felt NGG would not be significantly financially disadvantaged by tightening the buy-back incentive. We considered that a buy-back target level in the range £12.4 million to £13 million would allow NGG to earn sufficient revenue to incentivise it to contain buy-back costs.

We proposed that the changes should be implemented retrospectively from 1 April 2009 as this is the start of the formula year.

Default incremental entry capacity lead time

In relation to the default incremental entry capacity lead time, in the consultation, we considered that there was insufficient information on which to base a review since there had been only two incremental entry capacity signals since TPCR4. We proposed to defer our review of the default incremental entry capacity lead time until the next transmission price control review.

Consultation responses

There were eight responses to the consultation. A detailed summary of the responses is provided in Annex 1.

Entry capacity operational buy-back incentive

Seven supported the proposed target reduction with one opposing it. Four respondents supported retrospective implementation from 1 April 2009 whilst two did not. Those not in support argued that no material justification was given for retrospectivity and retrospectivity is illogical given actions have already taken place, leaving no opportunity for the affected party to respond.

One respondent noted the changes that had occurred since the NGG forecast in 2005 which Ofgem used to established the target of £18 million (as it was set at TPCR4). It argued that forecasts of demand and of the use of compressors are less than they were in 2005, resulting in a lower expectation of constraints. It also interpreted the licence to mean that the entry capacity incremental buy-back incentive covers the buy-back of incremental capacity delivered after 31 March 2007 and argued that as a result of this interpretation:

- a number of capex projects giving rise to potential constraints are not covered by the entry capacity operational buy-back incentive, and
- the decline in United Kingdom Continental Shelf (UKCS) flow forecasts results in gas coming via capex projects covered by the incremental incentive and so there is less risk for 'operational' buy-back.

It concluded that £13 million may be an upper value on the estimate of buy-back risk. Its analysis was supported by two other respondents.

All respondents agreed that it is appropriate to use the analysis we carried out at the time of the baseline review but for this analysis to be updated with the most recent data. One stated that the analysis was done for an intact network and would need to include the buy-back risk from planned and unplanned outages. Another respondent noted that there are other appropriate mechanisms available for unexpected events. One respondent thought that the extreme buy-back price witnessed in 2006 was the result of a one-off event and that the incentive mechanism should be based on the relationship between gas price and buy-back price.

Two respondents argued that keeping the cap and the collar the same when the target is reduced to £13 million would not reflect the level of risk faced by NGG.

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Default incremental entry capacity lead time

Seven respondents agreed with deferring the review of the default incremental entry capacity lead time. The only other respondent considered it possible that a review may be needed before the next price control review to account for the impact of the Planning Act.

NGG updated analysis

As an input to our decision, NGG updated the analysis which was conducted for our baseline review to estimate buy-back costs for 2009/10[13].

NGG took demand data from the 2008 Ten Year Statement (TYS) and applied its high east coast supply scenario assumptions[14] to estimate the constraint volumes at five demand points. The constraint volumes for each demand level were multiplied by the number of days in the Load Duration Curve (LDC) for which this demand level is expected, to estimate the total annual constraint volume. NGG also updated the severe LDC it had used during the baseline review. This update resulted in fewer days with high demand volumes than projected during the baseline review, which reduced the total annual constraint volume.

NGG used the estimated constraint volume to obtain an estimate of the total cost of constraints; this was done by multiplying the constraint volume by an assumed buy-back price (NGG assumed a buy-back price of 1.1 p/kWh[15]). The cost of constraints thus derived were taken to be an upper estimate of the costs of buy-back[16] such that buy-back costs are assumed to be less than this a certain per cent of the time[17]. The expected value of buy-back costs was then derived using the upper estimate and the properties of the frequency distribution curve.

NGG concluded from its updated analysis that the expected value of buy-back costs, rather than falling to the region of £13 million as we set out in our consultation paper, had actually increased above the current target level of £21 million. NGG argued that demand forecasts had declined significantly from those used to estimate buy-back at the time of the baseline review, and that these lower demand levels would result in less movement of gas away from potential bottlenecks on the NTS. Consequently, NGG claimed that the risk of constraints may be higher than currently, despite there being lower demand.

Ofgem views

Entry capacity operational buy-back incentive

In this section we discuss the four main issues raised by respondents. First, we discuss the scope of the entry capacity incremental buy-back incentive. Second, we consider the level of estimated entry capacity operational buy-back costs used to set the target. Third, we discuss the adjustments for buy-back resulting from planned and unplanned outages. Fourth, we discuss revisions to the entry capacity operational buy-back cap and collar.

Scope of the entry capacity incremental buy-back incentive

Some respondents considered that certain capex projects signalled at QSEC auctions before 31 March 2007 and delivered after 31 March 2007 are covered by the entry capacity incremental buy-back incentive and that this would reduce the 'operational' buy-back risk. However, we do not consider this to be correct. Special Condition C8D(5)(a) of the licence

[13] NGG submitted this to Ofgem in confidence on 24 March 2009.
[14] NGG employed a supply scenario to represent credible risk and the highest potential constraints on the network. It also revised its obligations at Easington upwards, by 345 GWh/day to account for incremental entry capacity to be delivered there from October 2009, and downwards at Garton.
[15] This is in current figures, when it is put into 2004/5 prices, for the purposes of the licence, it equates to 1.04 p/kWh.
[16] NGG assumed a lognormal distribution.
[17] NGG assumed that this to be 97.5 per cent.

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states that the incremental incentive covers incremental capacity which was released for sale after 31 March 2007 until it has been delivered (after the incremental capacity has been delivered it will be subject to the operational incentive). The Section 38A Notice, which introduced the incremental incentive in the licence, clarifies that the incremental entry capacity buy-back incentive relates to capacity resulting from long-term auctions held before 1 April 2007. Therefore, we do not agree with those respondents who considered that the risk of having to buy-back 'operational' entry capacity is reduced due to less entry capacity being classified as 'operational' entry capacity.

The level of estimated buy-back costs

Some respondents noted that a number of factors have changed since the analysis was originally undertaken to set the current buy-back parameters. In contrast, four respondents considered it appropriate to use the analysis carried out at the baseline review, but to update this analysis with the most recent data. We have used NGG's updated analysis as a basis for our views.

We reviewed NGG's updated analysis and note that under normal conditions, the probability of buy-back occurring is low. Therefore, more onerous conditions are required to test the NTS for its capability range and to estimate the upper confidence level for the probability distribution for the annual cost of buy-backs. We consider that NGG's most recent analysis employs extreme assumptions to set the upper confidence level for the distribution, namely:

- LDCs – the proposed average LDC was far more severe compared to the LDC derived from the actual flows in winter 2008/9, which in itself was considered harsher than average, and we assume that the severe LDC employed by NGG in its analysis is similarly over-estimated;
- buy-back price – NGG based its analysis on prices which include what we consider to be an 'outlier' buy-back event from July 2006, and this has introduced a significant upward bias in its estimates of average buy-back price. We examined the distribution of buy-back prices, excluding the July 2006 event, and found them to be Normally distributed. The prices of seven out of 9 buy-back events in July 2006 were more than three standard deviations greater than the mean of the buy-back prices observed at all other events. We therefore concluded that the July 2006 buy-back prices were 'outliers'; and
- high east coast supply scenario - this supply scenario is quite a difficult one for the NTS to accommodate, and NGG uses this to ensure there will be a constraint volume at each of the five levels of demand analysed. However, this should be used in conjunction with a number of other more moderate and more plausible supply scenarios to arrive at a balanced view of the probability of a constraint occurring. Consequently, NGG's modelling produces an upwardly biased view of likely constraint volumes.

In our view, the combination of these three extreme assumptions leads to a scenario which has an exceptionally low probability of occurring. NGG assumed the probability of this scenario occurring was 1-in-40. However, we concluded that the use of three extreme assumptions indicated that the outcome was at least three standard deviations above the mean, i.e. the confidence interval was at least 99.5 per cent. Applying this confidence level to NGG's analysis and its buy-back price assumption resulted in an estimated annual buy-back cost in the region of £13 million.

We then used less extreme buy-back price assumptions as inputs to NGG's model in order to estimate annual buy-back costs. As two extreme assumptions (using a severe LDC and a high east coast supply scenario) were implicit in this model, we considered that the confidence interval level on buy-back costs would be greater than that initially assumed by NGG (ie 97.5 per cent), but less than the level using three extreme assumptions (ie 99.5 per cent). This method provided estimates of annual buy-back costs in the range £9 million to £16 million.

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We also employed an alternative approach to estimating buy-back costs. This alternative method took NGG's modelling work to estimate constraint volumes at five different levels of demand, and applied NGG's average LDC, instead of employing a severe LDC, to get an average annual constraint volume. We applied one of the less extreme buy-back price assumptions to the average annual constraint volume. This provided an estimate of operational buy-back costs of £11 million.

We presented these alternative views to NGG at a meeting in June 2009. Following this, NGG raised some questions regarding the approach we had taken. NGG questioned our view that the buy-back price assumption of 1.1 p/kWh was based on outliers. NGG provided Ofgem with its view of this relationship between buy-back price and System Average Price (SAP) considering the relationship itself and the source of SAP data. This resulted in some debate on the analysis over the summer period, which we have now resolved. As such we continue to estimate annual buy-back costs to be £11 million.

Planned and unplanned outages

NGG noted that its modelling is for an intact network and so does not include planned and unplanned outages. It suggested that additional allowances should be made for the buy-back of capacity resulting from planned and unplanned outages. We recognise that an allowance is appropriate for unplanned outages. We consider that NGG can plan to significantly reduce the likelihood of buy-back occurring when it has planned maintenance periods. However, we recognise that it may not be possible for NGG to avoid all of the costs that arise from planned maintenance. In order to estimate the costs of buy-back resulting from unplanned outages we employed the two methods[18] that we used for estimating the buy-back costs for the intact network, as described above. Both methods suggested an allowance of £2 million is appropriate for the buy-back of capacity from unplanned outages. We used the same types of analysis to estimate the cost of buy-back from planned outages. This suggested a further adjustment of £0.5 million.

Taking this analysis into account we propose an entry capacity operational buy-back target of £13.5 million. This is comprised of £11 million of estimated buy-back cost from the intact NTS, and a £2 million and a £0.5 million adjustment for buy-back costs from unplanned and planned outages respectively. We therefore use this figure to reset the target for the incentive.

Cap and collar levels

Two respondents noted that reducing the buy-back target below the current level of the cap and collar would require these parameters to be reduced in order to balance the incentive. We consider that, consistent with the approach taken at TPCR4, the cap and collar should be no wider than the target. We therefore decided to reduce the cap to £13.5 million, in line with the revised target level. We also propose to reduce the collar to £10 million. Even though we consider that the buy-back price assumption used by NGG to be based on an outlier event compared to the Normally distributed buy-back price data, we note that there is potential for extreme outlier events to occur. In recognition of this asymmetric risk faced by NGG, we consider it appropriate that NGG's downside risk from the incentive should be less than the estimated level of buy-back costs.

Resetting the incentive parameters for operational buy-back costs provides a stronger incentive on NGG to contain buy-back costs and therefore operate the NTS more economically through managing buy-back. A target of £13.5 million should still allow NGG

[18] The first method used NGG's modelling analysis, but both a lower buy-back price and a greater confidence level in a manner similar to the calculation of target constraint costs. The second method used an average LDC to get the average annual constraint volume which was then multiplied by one of the less severe buy-back price assumptions to get average outage buy-back costs.

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to earn sufficient revenue to incentivise it to contain buy-back costs and not significantly disadvantage NGG.

We propose to implement the changes effective from 1 January 2010; we do not consider it to be appropriate in this case to make retrospective changes from 1 April 2009 as it does not provide NGG with sufficient opportunity to react so late into the formula year.

Default incremental entry capacity lead time

As there had only been two incremental entry signals since TPCR4 at the time of consulting we considered there was insufficient information on which to base a review of the default incremental entry capacity lead time. We remain of this view. However, we note that all three incremental signals received since TPCR4 are to be delivered on accelerated timescales of less than 42 months, and in the most recent case at Hole House Farm, on a significantly shorter timescale of 24 months. This may have implications for the permit scheme[19], which incentivises NGG to deliver incremental capacity earlier than 42 months, when it is reviewed at the next price control. We expect that this incentive will be reviewed alongside the default incremental entry capacity lead time.

Decision

Following consideration of the consultation responses, the updated buy-back analysis and having regard to the Authority's principal objective and statutory duties and for the reasons set out above, the Authority has decided that it will[20]:

- reduce the entry capacity operational buy-back target from £21 million to £13.5 million, effective from 1 January 2010;
- reduce the entry capacity operational buy-back upside cap from £18 million to £13.5 million, effective from 1 January 2010;
- reduce the entry capacity operation buy-back downside collar from £18 million to £10 million, effective from 1 January 2010; and
- defer review of the default incremental entry capacity lead times until the next full transmission price control review.

Accompanying this letter is a Section 23 Notice with our proposed modifications to the licence to implement our decision and change the entry capacity operational buy-back target, upside cap and downside collar. Subject to any representations and National Grid Gas's consent, we aim to implement the revised licence condition effective from 1 January 2010.

Yours sincerely,

Stuart Cook
Acting Senior Partner, Transmission & Governance
Signed on behalf of the Authority and authorised for that purpose.

[19] At TPCR4 we introduced a process to allow NGG to vary the lead time to be shorter or longer than 42 months through a system of 'gas entry permits'. Under this system NGG receives an initial allowance of gas entry permits at the start of the price control period and it can either earn additional permits (by agreeing in advance of the QSEC auction to deliver capacity earlier than the default lead time) or use up its allowance of permits (by announcing in advance of the QSEC auction to deliver capacity later than the default lead time). At the end of the price control period each unused permit provides NGG with additional revenue.

[20] As the parameters are being modified midway through the 2009/10 formula year we have calculated a transitional figure weighted by the number of months in the licence.

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Annex 1: Consultation Responses

Entry capacity operational buy-back

Do you agree with the assessment we have set out for Option 1 - changing the cap and collar of the incentive?

One respondent agreed that changing the cap and collar would not make any difference given that NGG had not reached the extremes of the performance measure. Three others also agreed that changing the cap and collar was not the best means for setting appropriate incentives over the next three years.

Two respondents disagreed arguing that keeping the cap and collar the same when the target is reduced to £13 million would not reflect the level of risk faced by NGG.

Do you have any views on lowering the incentive collar to better protect consumers?

One respondent stated that a lower incentive collar could better protect consumers and the performance measure and target need changing to reflect reduced buy-back risk. This respondent and three others thought a lower collar would have no material impact on NGG's behaviour.

Two respondents reiterated their views that the cap and collar need reviewing as their current levels would be disproportionate with a target of £13 million.

Do you agree with the assessment we have set out for Option 2 - changing the sharing factor of the incentive?

Four respondents agreed that it is not appropriate to change the sharing factor at this stage. One clarified this by saying that changing the target was the best way to sharpen the incentive.

One respondent thought that all incentive scheme parameters must be considered in the round and not separately. Another thought that a greater share of benefits should be passed on to consumers and that all parameters should be considered at the next review.

Do you agree with our analysis of NGG's historic performance regarding the incentive?

Five respondents agreed with our analysis. They noted that the buy-back costs in 2006/7 were due to a single event (Easington capacity not being available to support new pipeline) whose level of risk was unlikely to be repeated. One respondent continued that there are other appropriate mechanisms available for other unexpected events.

One respondent thought the analysis was incomplete as need to consider future risks and not place too much emphasis on historic performance, especially in light of uncertainty over future flow patterns.

Do you agree with the analysis of the estimated future buy-back risk? Specifically, do you agree with NGG's application of a lognormal assumption for the distribution of buy-back costs? Do you agree with the use of historic buy-back prices in estimating future buy-back risk?

Three respondents did not agree with the estimated future buy-back risk analysis as considered that major changes have occurred since the existing incentive was set, these are:

- gas demand forecasts have reduced which reduces the expectation of constraints
- reduced compressor use is forecast so expectation of constraints less than previously considered (as considers compressors to be source of constraints)

- they interpreted the entry capacity incremental buy-back incentive to cover buy-back of incremental capacity delivered after 31 March 2007 which means that:
  i. a number of capex projects giving rise to potential constraints is not covered by the entry capacity operational buy-back incentive
  ii. decline in UKCS flow forecasts results in gas coming via capex projects covered by the incremental incentive and so less risk for 'operational' buy-back

Another agreed that lower demand and UKCS supplies coupled with lower compression use should be taken into account in calculating buy-back risk.

Two respondents thought that it is important that not too much weight placed on historical data. One of these considered that underlying buy-back risk is now greater going forward.

One respondent thought the lognormal distribution was an appropriate assumption.

One respondent thought that the extreme buy-back prices witnessed in 2006 should not be used as these were a one-off and that relationship between buy-back price and gas price should be considered. Three respondents thought that actual buy-back prices should be lower than historical values due to greater diversity of entry flows and shippers' market shares going forward.

Do you consider it appropriate to use the analysis done at the baseline review as part of forming our decision on reviewing the entry capacity operational buy-back incentive?

All those commenting seemed to think it appropriate to use analysis done at the baseline review updated for most recent data.

One noted that the baseline review analysis was conducted on an intact network and would need to include buy-back risk arising from planned and unplanned outages.

Do you agree with our view that an entry capacity operational buy-back incentive target of £13 million per year will still provide NGG with sufficient incentives to contain the costs of buy-back?

Five respondents agreed that an incentive target of £13 million would still provide NGG with sufficient incentives to contain the costs of buy-back.

Another respondent noted that if Ofgem aims to reduce incentive revenue then it should reduce the risk that NGG faces which could be done through reducing the collar, target adjusters or specific risk carve-outs.

Do you consider that a £13 million entry capacity operational buy-back incentive target is appropriate given NGG's return on equity performance?

Four respondents thought that a £13 million target was appropriate given NGG's return on equity performance.

Two others noted the importance of the incentive striking a balance between risk and reward and that reducing the target would require that the cap and collar be reduced too.

Do you agree with our provisional view to reduce the target level of the entry capacity operational buy-back incentive to £13 million per year?

Seven respondents agreed that a £13 million target was appropriate, four of these thought that £13 million may be an upper limit given their views that major changes have taken place since the existing incentive was set.

The other respondent did not agree, arguing that reducing the target without reducing downside risk that NGG faces was not an appropriate balance of risk and reward.

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Do you agree with the assessment we have set out for Option 4 - doing nothing and keeping the incentive in its current form?

Five respondents did not think it appropriate to keep the incentive in its current form given the changes in risk and NGG's potential to outperform.

Do you agree with our proposed approach of retrospectively modifying NGG's gas transporter licence by implementing the proposed changes to the entry capacity operational buy-back incentive parameters as of 1 April 2009?

Four agreed with retrospective implementation.

Two respondents did not agree with retrospective application due to it being inconsistent with Ofgem's decision to amend the target resulting from the baseline review, there being no material justification for doing so and as actions would already have taken place it would not give NGG an opportunity to respond.

Are there any other considerations which we have not highlighted which we should have taken into account? Other comments.

Those comments directly concerned with the buy-back review noted that changes in forecast patterns of beach flows, completion of projects which will increase the capacity and flexibility of the NTS and the decline of UKCS volumes would reduce requirement for constraint management risks.

One noted that NGG has not outperformed the incentive with 'ease' and that it employs a range of mechanisms to ensure buy-back minimised e.g. accelerated outages through weekend working and overtime, rescheduling outages in response to market conditions, scheduling outages over weekends and expediting responses to compressor trips.

Default incremental entry capacity lead times

Do you agree with our proposal to defer the review of the default incremental entry capacity lead times until the next transmission price control review?

Seven respondents supported deferring the review of the default incremental entry capacity lead time until the next transmission price control review. One of these noted that NGG has permits to play on bringing investment on earlier or delaying it without incurring financial penalties and so did not see a need for further measures at this stage. Others noted that the impact of developments including Planning Act 2008 and entry capacity substitution would need to be considered at the next review.

The other thought that it was possible that a review may be needed before the next price control review to account for the impact of the Planning Act.

Are there any other considerations which we have not highlighted which we should have taken into account? Other comments.

One respondent noted that the modification proposal UNC230 and its alternatives would result in QSEC auctions being held in March allowing for capacity to be built over the summer months before October delivery which would conflict with NGG's desire to have a 48 month lead time.

Another respondent noted that NGG campaigned to ensure an amendment was made to the Planning Act 2008 to cover pipelines and that it was understood from roundtable discussions that this would not impact on lead times. The respondent believed that this would actually reduce lead times.

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