Ofgem's Initial proposals on interim incentive schemes supporting the offtake arrangements
Comments from the Association of Electricity Producers

5 April 2005

The Association of Electricity Producers welcomes the opportunity to comment on this initial proposals document.

The Association notes that most elements of the current exit incentive scheme will be retained and we broadly agree that this is a pragmatic approach to provide some certainty and stability in the incentive regime. However we do have some concerns that in some areas Transco may receive incentive revenue, not as a result of improvements in operational efficiency in response to the incentives but merely as a result of mild weather. This does not seem to be appropriate and should be reconsidered perhaps normalising the targets to average cold spell conditions as per the NGC incentives. We also note that Transco will be expected to establish a 'buy-back' facility but that little is known about how this would operate.

NTS interim incentives

We would welcome more clarity on how the incentive year from April 2008 to March 2009 will be handled as this will cover a period when both the interim and enduring offtake arrangements apply. Paragraph 4.37 seems to suggest that these interim incentives will only apply upto 30 September 2008, and yet the target values for charges foregone seem to comprise full year revenues, we do not understand this. In addition we would not normally expect interruption to occur in the summer months (although we note interruption did occur in summer 2003) it would therefore be truly exceptional if >15 days interruption were required in the summer, we therefore suggest the >15 day target is set to zero for 2008/9. Similarly we would not normally expect constrained LNG to be required in the summer so suggest this target is also set to zero for 2008/9.

We understand that the current price control only contains a single baseline value for firm NTS exit capacity at direct connects, but we are unclear as to how this relates to the aggregate NTS exit capacity currently booked. We would welcome some clarification on this as it would appear to be important in determining whether additional capacity has been provided. Similarly as there is only a single UCA defined for NTS exit capacity we have some concerns that this may not be cost reflective at all parts of the network.

The proposed targets for the >15 day incentive increase in 2007/8, it is not clear why this is the case. Historically there has been very little NTS interruption and no >15 day payments have yet been made for NTS connected sites. We note that this appears to be linked to the growth assumptions from the Ten Year Statement, but would welcome further clarity on why this should lead to increased NTS interruption. Does this include interrruption for supply /demand reasons that is currently subject to a modification proposal to remove this right from Transco? As stated above we consider that this incentive should be reconsidered and rebased to more average winter conditions, otherwise Transco will receive incentive revenue simply as a result of the weather being less severe than anticipated under the incentive. However we accept this is a more major change and perhaps should be considered for the enduring incentives and / or at the next price control.

The Association was surprised to read that Transco expects the NTS to have sufficient spare capacity to provide most interruptible sites with firm capacity right in the interim period should they so wish. This appears inconsistent with previous statements made by Transco that under severe conditions all interruptible sites will be interrupted for a significant period of time. If Transco really does consider this is the case, we would seek assurances that it can meet its 1 in 20 licence obligations.

We therefore support option 2 for the buy-back and interruption sharing factors so that Transco will receive less incentive revenue for doing nothing under normal winter conditions.

With respect to the constrained LNG incentive we agree that the 100% sharing factors continue to be appropriate. For the target we suggest that the lower value is adopted as under peak demand conditions it would be logical to expect all storage facilities to be delivering gas at their maximum rates or close to it.

We consider that option 2 ‘revision’ should be adopted for the charges foregone incentive target, since this is effectively part of a new price control period and it is therefore appropriate to consider external issues which have caused charges to change. Transco state that the significant rise in exit charges from April 2005 is mostly due to a large increase in business rates which can be passed through in TO allowed revenue. Notwithstanding the comments above with respect to the 2008/9 incentive year, we do not entirely understand the proposed reduction in the target for this year, although it would be welcome. As we understand this the revenue is linked to capacity payments and does therefore not vary with the amount of interruption called as the >15 day payments might.

DN interim incentives
The Association agrees with the proposed duration of the incentives scheme and the sliding scale structure, we also agree that a single incentive is appropriate in the interim period.

We are unclear as to why Ofgem proposes pricing flexibility capacity at the same level as flat capacity, as this would not be cost reflective. Ofgem considers this should be the case as in the interim period NTS direct connects could only secure additional flexibility by buying capacity. However it is our understanding that in the interim period NTS direct connect will still need to register the site SOQ as 24 x the SHQ and that by definition this will ensure that adequate flexibility is secured such that additional flexibility will not be required.

The Association considers that option 1 for the parameters for the DN incentive scheme would be most appropriate to ensure the DNs are fully incentivised with respect to decision they make. We would also welcome clarity on how any incentive payments will be funded, and whether this will require a change in the DN charging methodology.