Direct Dial: 0171-932-6337

05 October 2000

BG Transco, Shippers and Other Interested Parties

Your Ref:
Our Ref : Net/Cod/Mod/430

Dear Colleague,

Modification Proposal 430: Removal of Monthly Incentive Limit Amount

Ofgem has considered the request from British Gas Trading for modification proposal 430*, 'Removal of Monthly Capacity Incentive Limit Amount'* to follow urgent procedures.

We recognise the concern expressed in the proposal that BG Transco may have reached its monthly incentive limit, thereby reducing its direct commercial incentive to seek to reduce the costs of any entry capacity buy-backs as a result of further NTS entry constraints at St Fergus. We do not believe, however, that this modification should be progressed on an urgent timetable.

Ofgem has repeatedly made clear the importance of the regulatory principle that for incentives to be effective, they must not change materially within the agreed period unless new information comes to light that could not reasonably have been forseen when the incentives were set. Reopening the incentives in the light of a few days experience and a series of BG Transco capacity buy-backs would arguably undermine the credibility of any future incentive regime. In this context, Ofgem believes therefore that there is little to be gained by granting this modification urgent status. Indeed in these circumstances granting urgency may unduly hinder an effective consideration of the issues that it raises concerning the nature of the capacity incentive.

Ofgem notes that the issue of revising BG Transco's capacity incentive scheme, which was initially put in place for one year from the launch of NGTA on 1 October 1999, has been raised frequently over the last few months. Indeed Ofgem made clear in its July 2000 Review document that it would welcome exploration of potential changes to the capacity regime to address the positive bias that we identified existed at the time. In addition we indicated that we would like to see the caps and collars and sharing factors increased over time to sharpen BG Transco's incentives. Subsequent to the release of the July review document our decision on Modification 417, *'Revisions to the Capacity Incentive'* also indicated that we would welcome a discussion of these issues. Further, I would also note that BG Transco raised the issue of revising the capacity incentive at workstream meetings leading up to the revisions to the regime introduced prior to the August auctions including changing the existing sharing factors.

In the light of these circumstances it is disappointing to note that shippers did not initiate any discussions or raise any modifications on these issues prior to the August auctions despite having ample opportunity to do so, particularly when they have been made fully aware of Ofgem's views on mid-term changes to incentives. Such a discussion would have been worthwhile particularly in circumstances where the increase in volumes of monthly firm capacity to SND+10% levels has potentially made the incentive more symmetrical.

In conclusion therefore, Ofgem believes that it is more appropriate for the modification to be addressed through Development Workgroup processes.

If you have any queries in relation to the issues raised in this letter, please feel free to contact me on the above number.

Yours sincerely,

Mark Feather
Head of RGTA