

The Joint Office, Relevant
Gas Transporters, shippers and other
interested parties

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Dear Colleague

**Supplement to the Consultation on the Incremental Entry Capacity Release
(IECR) Methodology Statement 2007**

On the 8th May 2007 National Grid initiated its industry consultation on its proposed Incremental Entry Capacity Release (IECR) Methodology Statement. Subsequently we have been asked to bring to the attention of consultees two specific issues that may not be immediately evident from initial reading of the statement and to seek opinions on these issues.

Connecting Pipelines

Paragraphs 100 and 102 contain formulae for determining incremental price steps, the latter being in respect of new entry points. It can be seen that the formula for new entry points includes a component for the cost of providing a connecting pipeline. This means that the cost of the connecting pipeline is considered in any assessment of the economics of providing incremental capacity. However, as the economic test currently only requires a User commitment of 50% of the NPV of the investment (paragraph 35), then it is possible that the relevant Shippers at the new entry point will only pay 50% of the cost with the Shipper community as a whole paying the remainder.

National Grid would welcome views as to whether the NPV test for new entry points, where National Grid is to provide the connecting pipeline, should be strengthened in respect of the connecting pipeline costs.

Step Price Determination

National Grid has recently raised its Gas Charging Methodology consultation NTS GCM06 which covers the determination of the Obligated NTS Entry Capacity reserve prices. NTS GCM06 is a follow up to NTS GCM01 which was raised to cover the setting of Obligated NTS Entry Capacity reserve prices using a Transportation Model. The Obligated NTS Entry Capacity reserve prices are set using the Long Run Marginal Costs (LRMCs) calculated from modeling flow at the obligated capacity level. In its non-veto decision letter on NTS GCM01, Ofgem raised concerns about "spare" capacity.

As a consequence of the NTS GCM01 decision letter, National Grid raised NTS GCM06 which covers the setting of Obligated NTS Entry Capacity Charges based on a maximum forecast flow approach (capped at the obligated level); option 2a from the original NTS GCM01 document. This approach factors in “spare” capacity in that it will always produce prices that are equal to or less than the NTS GCM01 approach with the discount proportional to the “spare” capacity.

The IECR Methodology Statement introduces the Transportation Model as the basis for the setting of the Incremental Entry Capacity price schedule. Prices will be based on Incremental Costs calculated from the model for each step increment. The first price step, or P_0 price step, represents the obligated capacity price as calculated from the Charging Methodology. The IECR proposes that each subsequent price step is calculated from the P_0 price plus the annuitised difference between the marginal cost at the incremental entry capacity level and the marginal cost at the obligated level.

The issue for the IECR with this approach is that it may understate the costs where the forecast level is less than the obligated level i.e. the cost of capacity from the forecast level to the obligated level is omitted.

National Grid would welcome views as to whether, for the purposes of determination of incremental entry capacity price steps, the calculation should be based on the P_0 price or based on a price calculated at the obligated level (option 2b from the original NTS GCM01 document) should NTS GCM06 be implemented (if NTS GCM06 is implemented). This can be summarized as: If a discount is introduced for the P_0 level where there is “spare” capacity, should this discount also apply to the incremental price steps?

Should you require clarification on either of these issues please contact me at andrew.fox@uk.ngrid.com or on 01926 656217.

Responses to the proposed IECR should arrive at National Grid by 17:00 on 5th June 2007. They should be sent to:

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Alternatively they can be sent by e-mail to:
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Yours sincerely

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