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8 February 2010

Dear Andrew,

### **Incremental Entry Capacity Release (IECR) Methodology Statement**

On 13 November 2009, National Grid Gas (NGG) proposed making revisions to the IECR methodology statement for approval by the Authority. This letter provides background information on the proposed revisions made by NGG and provides the Authority's decision on this matter, together with the reasons for the Authority's decision.

Having regard to the principal objective and statutory duties of the Authority<sup>1</sup>, and for the reasons set out in this letter, the Authority has decided not to veto the proposed revisions to the IECR methodology statement pursuant to Special Condition C15(6)(b) and (c) of NGG's gas transporter licence (the "Licence").

### **Background**

The IECR methodology statement describes the methodology by which NGG determines whether to make incremental entry capacity available for sale to gas shippers. On 13 October 2009 NGG initiated a consultation<sup>2</sup> as part of its review of the IECR methodology statement pursuant to Special Condition C15(5)(b). As a result of this, NGG is proposing a number of revisions to the IECR methodology statement. The proposed changes are:

- To reduce the minimum incremental step size for entry capacity bids at new Aggregated System Entry Points (ASEPs) from 15 GWh to 5 GWh;
- A clarification to paragraph 82 which describes the process to determine incremental step sizes for new ASEPs;
- Revisions as a result of GCM17 'QSEC New ASEP NTS Entry Capacity P0 Pricing'<sup>3</sup> which removes references to setting P0 prices at zero for new ASEPs;
- Changes to date from which the IECR methodology statement becomes effective.

On 13 November 2009, following the close of NGG's consultation on the proposed revisions to the IECR methodology statement, NGG submitted the IECR consultation report to the Authority, consistent with the provisions of Special Condition C15(5)(c). The Authority has the power to veto these proposed revisions if, pursuant to Special Condition C15(6)(c), it directs NGG not to make them in the 28 day timeline contained in Special Condition C15(6)(b).

<sup>1</sup> Set out in Section 4AA of the Gas Act 1986, as amended.

<sup>2</sup> A copy of NGG's consultation can be found at <http://www.nationalgrid.com/uk/>

<sup>3</sup> A copy of the Authority's decision letter can be found at <http://www.ofgem.gov.uk>

## **Respondents' views**

NGG received one response to the consultation it published on 13 October 2009. The respondent noted its agreement to reduce the minimum incremental step size for new ASEPs from 15 GWh to 5 GWh.

The respondent stated the current minimum incremental step size can act as a barrier to the development of small new ASEPs on the National Transmission System (NTS) and consequently can prevent developers sending appropriate investment signals to NGG.

## **Ofgem's view**

We have decided not to veto the proposed modifications to the IECR methodology statement. In reaching this decision, we have carefully considered the proposed revisions to the methodology statement against both our statutory duties and the responses to NGG's consultation.

It is our view that the proposals are consistent with our principal objective and wider statutory duties as the modification will improve NGG's ability to develop an economic and efficient pipeline system. The current minimum incremental step size has the potential to render new small ASEP developments unviable by compelling developers to overbook their capacity requirements. For example, a 15 GWh minimum incremental step size compels a developer a new small ASEP which requires 20 GWh of capacity to either overbook their requirements by 50% or under book by 33%.

The revised minimum step size of 5 GWh should give developers and Shippers greater scope to fine tune their capacity requirements in line with the size of the development opportunity and minimise the costs they incur to book capacity. This should also result in NGG receiving more precise investment signals and thereby facilitate the efficient and economic development of the network.

The reduction in the minimum step size should not affect larger new entry point developments. Their step size will still be calculated as one twentieth of 150% of their capacity requirements.

We also consider that the reduction of the minimum incremental step size will help facilitate competition. The lower minimum incremental step size will reduce barriers to entry for new small ASEPs to connect to the NTS and should increase the range of gas sources which Shippers can use to meet their capacity obligations.

NGG has also proposed changes to the IECR methodology statement to bring it in line with the Authority's decision not to veto GCM17. GCM17 amended the Gas Transmission Transportation Charging Methodology so that the reserve price for new entry points is set consistently with the methodology used for existing points. Reserve prices for new entry points are now set at the annuitised long run marginal cost (LRMC) using the transportation model and constrained at 0.0001 p/kWh per day for ASEPs with a negative LRMC. Prior to GCM17's implementation on the 1 July 2009, reserve prices for new entry points were set at zero which was considered to be potentially discriminatory against existing entry points and could create a perverse incentive to encourage users to locate new entry points close to an existing ones so that they can pick up some of the capacity for free.

We are content that the deletion of text in paragraph 84 which refers to P0 prices at new ASEPs equalling zero reflects the intent of GCM17.

## **The Authority's Decision**

Following consideration of the documentation provided and having regard to the Authority's principal objective and statutory duties and for the reasons set out above, the Authority has

decided not to veto the proposed revisions to the IECR methodology statement pursuant to Special Condition C15(6).

In doing so, we note NGG's letter to the Authority of 13 November 2009, which accompanied the Consultation Conclusions Report and associated documentation, states in the penultimate paragraph that the Authority has a two month period to consider the proposals. This time period is correct when considering the annual review of the IECR methodology statement<sup>4</sup>. However, Special Condition C15(6)(b) and (c) provides that the Authority has a 28 day period to issue a direction for proposed revisions to the IECR methodology statement made out with the annual review period. As the current proposals are outside the annual review period the revisions to the IECR methodology statement discussed above became effective on 1 January 2010.

This document constitutes a notice of reasons for the decision pursuant to section 38A of the Gas Act 1986.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Stuart Cook', written over a horizontal line.

Stuart Cook

**Senior Partner, Transmission and Governance**

**Signed on behalf of the Authority and authorised for that purpose.**

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<sup>4</sup> Special Condition C15(4)