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Dear Andrew

NTS Exit Capacity Release Methodology Statement in respect of the Transitional and Enduring Exit Periods

On 29 March 2011, National Grid Gas NTS ("NGG NTS") submitted to Ofgem¹ the National Transmission System (NTS) Exit Capacity Release (ExCR) methodology statement (the "Statement") in respect of the transitional and enduring periods. This was submitted pursuant to Special Condition C18 (the "Condition") of NGG NTS' gas transporter licence (the "Licence").

Having regard to the principal objective and statutory duties of the Authority², the Authority has decided to approve the Statement. This letter sets out our reasons for this approval. We also use the letter to direct, under Special Condition C18.2, that the next NTS Exit Capacity Release Methodology Statement, due in 2012, should be accompanied by a statement from appropriate auditors. This needs to confirm that the auditors have carried out an investigation and give their opinion as to the extent to which the proposed methodology is in line with NGG NTS's duties under the Act, and the Standard Special and Special Conditions of its Licence.

Background

In January 2009 Ofgem directed implementation of Uniform Network Code (UNC) modification proposal 195AV which introduced reform of the booking arrangements for NTS exit capacity ("exit reform")³. These new exit arrangements are for the use of capacity from 1 October 2012 which means that there are two separate phases for release of NTS exit capacity, namely:

- the 'Transitional Exit Period' for capacity reserved or allocated to Users commencing no later than 30 September 2012; and
- the 'Enduring Exit Period' in respect of capacity reserved or allocated commencing no earlier than 1 October 2012.

¹ Ofgem is the Office of the Gas and Electricity Markets Authority. The terms 'Ofgem', 'the Authority', and 'we' are used interchangeably in this document.

² Set out in Section 44A of the Gas Act 1986, as amended.

³ UNC 195AV: Reform of the enduring NTS capacity arrangements, 19 January 2009. A copy of this decision is available on the Joint Office of Gas Transporters website: www.gasgovernance.co.uk

The Statement describes the process by which NGG NTS determines how it will release NTS exit capacity to users and Gas Distribution Networks (GDNs). The first iteration of the Statement following implementation of exit reform was submitted to the Authority in March 2009 to be applied with effect from 1 April 2009. This is the third submission following the implementation of exit reform.

On 22 February 2011 NGG NTS initiated its formal consultation on its proposed changes to the 2010 Statement. The version (6.2) of the Statement submitted to the Authority on 29 March has been revised to take account of the issues raised in the consultation (see NGG NTS' Consultation Conclusions Report⁴ for further detail). NGG NTS propose that the new Statement be applied from 1 June 2011. In the section below we summarise the substantive changes proposed, and in the subsequent sections we set out respondents' views and our views on the changes.

Proposed changes to the Statement

Changes to Part A

Part A of the Statement concerns the arrangements applying in the remainder of the Transitional Exit Period. Changes here include two new paragraphs clarifying the Licence process for NTS Exit Points in order for exit capacity to be released and/or an Advance Reservation of Capacity Agreement (ARCA⁵) to be signed. The majority of the remaining changes in Part A are the removal of references to requests for the release of Incremental Exit Capacity beyond investment lead-times (since it is no longer considered to be applicable as we approach the Enduring Exit Period).

Changes to Part B

Part B of the Statement concerns the arrangements applying in the Enduring Exit Period. Changes here include: the removal of sections that duplicate the UNC, by referencing the UNC where appropriate; the removal of duplicate sections within the Statement; the provision of clarification on certain sections; and, the inclusion of new paragraphs relating to NGG's views on default lead times for capacity delivery and capacity release dates for non-users⁶.

The removal of sections that duplicate content from the UNC is in direct response to users' views from last year's consultation.

Respondents' views

There were four responses to the NGG NTS' consultation.

One respondent commented solely on Appendix 2 of NGG NTS' consultation. Appendix 2, 'Supplementary Consultation' invited views from the industry on addressing User Commitment and the reduction process when a) anticipated new load does not materialise or b) actual prices rise above P_{ind} ⁷. The respondent commented that under the current NTS exit arrangements a user must commit to capacity in financial terms based upon P_{ind} . The respondent noted that the nominal four year commitment duration is proportionately reduced if actual prices exceed the indicative prices, ensuring that the original financial user commitment level is maintained.

⁴ Review of the NTS Exit Capacity Release Methodology Statement in respect of the Transitional and Enduring Exit Periods. Consultation Conclusions Report. National Grid 29 March 2011.

⁵ ARCAs are agreements between NGG NTS and a counterparty whereby future capacity is reserved.

⁶ A non-user (the "Reservation Party"), is a party who is not a signatory to the UNC but is able to reserve an amount of Enduring Annual NTS Exit (Flat) Capacity in respect of an NTS Exit Point via an ARCA.

⁷ P_{ind} is the indicative NTS Exit Capacity price (p/kWh/Day) for the relevant capacity at the NTS Exit Point. This price may differ from the actual price determined at a later date.

The respondent believes that this is undermined by the capacity reduction rules which in effect set a duration-based (rather than financially-based) minimum commitment of 12 months, irrespective of actual price levels. It believes that the effect is to discriminate against users holding capacity for which actual prices turn out to be more than four times the indicative prices. It proposes an adjustment of the user commitment rules to address this issue.

One respondent commented on the new paragraph 41 in which NGG NTS state that they consider it extremely challenging to meet their Licence default lead-time of 38 months. The respondent explains that they infer from this statement that NGG NTS will be incapable on some occasions of fulfilling their current Licence obligations.

One respondent commented on the introduction of paragraph 68, which seeks to clarify the capacity release dates available to non-Users who pursue the ARCA process. While the respondent understands why NGG NTS may have introduced this, it considers it inappropriate to propose such changes via the ExCR.

Two respondents indicated that the ExCR along with other methodology statements should be incorporated into the UNC. They highlighted that it would avoid the development of rules, processes and procedures outside of the robust and open UNC process. In addition, it would avoid the duplication of significant UNC sections and allow users to raise change proposals in a manner consistent with the charging methodology.

One respondent indicated that there is disjoint between new connections and providing additional NTS exit capacity. They argued that a preliminary works agreement (PWA) issued at NGG NTS' discretion would not alleviate this disjoint as suggested by NGG NTS. Furthermore, it indicated that more needs to be done in order to rationalise or combine the connection and capacity provision processes.

The Statement referenced the possible release of NTS Offtake (Flexibility) Capacity where investment is required. One respondent stated that they considered it premature to introduce the concept into the ExCR and that they had not been convinced by the arguments put forward by NGG NTS.

Three respondents commented on the current revenue driver process and were keen to understand when the generic methodology for determining revenue drivers would be issued.

Ofgem's view

In reviewing this document the Authority considers that it complies with the requirements of Special Licence Condition C18, against which it was submitted, and therefore grants its approval to the methodology. Below, we give our views on both the issues raised by respondents to the consultation exercise undertaken by NGG NTS and the form and content of the new Statement.

Comments on respondents' views

We note the views of the respondent who is concerned about how financial commitment might be distorted in instances where there is a significant increase in actual prices relative to indicative prices. NGG NTS has already indicated that it would consult on this issue as part of the 2012 ExCR process. We think it more appropriate that this debate is brought forward ahead of that process, so that industry gets the opportunity to fully engage in determining an appropriate solution.

The Statement is meant to be an objective representation of the process for releasing exit capacity on the NTS. It should generally be free of subjective views on NGG NTS' difficulty of meeting its Licence obligation (such as paragraph 41); but in this instance, we can see

how it links to inform how interested parties can facilitate the timely release of capacity through active engagement.

When new principles governing NTS exit capacity release are introduced we expect it to be done via the well established UNC modification process. The principles introduced by paragraph 68 relate to non-users and NTS exit capacity release dates via the ARCA process. Non-users are not signatories to the UNC and therefore the Statement is the appropriate document to include these principles. We would encourage NGG NTS to ensure that adequate consultation takes place with industry before new principles are included in the Statement.

Shippers have raised the issue of whether the various methodologies produced by NGG NTS could be incorporated into the UNC in other fora, apart from this consultation. We consider that this would be a natural consequence of the Code Governance Review process. Ofgem has begun to look at how the current methodology statements could be incorporated into the UNC and the associated changes to the Licence that may be required as a result. However, we note that the current UNC regime allows for a user to propose introducing an existing methodology statement into the UNC if they wish to.

We are aware that the issue of disjoint between new connections and the provision additional NTS exit capacity could lead to possible changes and clarification of both the connection and capacity allocation arrangements. We note that these arrangements are currently under consideration through the workgroup of UNC Mod 0373⁸. Ofgem expects to take an active part in these discussions with the objective of facilitating a more efficient and holistic set of arrangements.

We acknowledge the concerns of the respondent in relation to the funding of flexibility capacity. We expect discussions on the merits of such options to take place through the RIIO-T1 and RIIO-GD1 frameworks.

Finally, in relation to the timescale for determining a generic revenue driver methodology, Ofgem expects to consult on this during the July/August 2011 period, once current revenue driver requests have been dealt with.

Other comments on the Statement

We consider it appropriate for NGG NTS to have removed sections from the Statement that merely duplicated what was already in the UNC or featured within other sections of the Statement. We also welcome that specific UNC references have been included in the Statement in order to add further clarity to this document. The work undertaken to ensure clarity through these minor drafting changes ensures that the Statement maintains a clear hierarchy of accountability; reduces the administrative burden when changes are made to UNC; and, it removes repetition within the Statement which makes it more readily understood.

We note that NGG NTS has added helpful clarifications of: how reduction requests less than 14 months in advance will be considered; how the indicative price is calculated if it is anticipated that NTS obligated incremental capacity is required to be released; and, how permits will be addressed if NGG NTS identify an opportunity to reduce the lead-time to deliver NTS Exit (flat) Capacity.

In addition to the issues raised by the respondents we have noted a number of minor issues that we believe merit attention by NGG NTS. We have detailed these in Appendix One of this letter.

⁸<http://www.gasgovernance.co.uk/0373>

Methodology Statement review in advance of the NTS Enduring Exit Period starting in 2012

In advance of the start of the NTS Enduring Exit Period, we believe that NGG NTS should take steps to ensure that the methodology that will determine the release of NTS Exit Capacity is robust and in line with NGG NTS's duties under the Act, and the Standard Special and Special Conditions. Accordingly, under Special Condition C18.2, we direct that the next NTS Exit Capacity Release Methodology Statement, due in 2012, should be accompanied by a statement from appropriate auditors, confirming that they have carried out an investigation and giving their opinion as to the extent to which the proposed methodology is in line with these duties. The scope and objectives of the investigation must be approved in advance by the Authority.

Authority's decision

Following consideration of the documentation provided by NGG NTS pursuant to Special Licence Condition C18 and having regard to the Authority's principal objective and statutory duties, the Authority approves the NTS Exit Capacity Release Methodology Statement subject to the required amendments as set out above.

Yours sincerely



Hannah Nixon

Partner, Transmission

Signed on behalf of the Authority and authorised for that purpose by the Authority

Appendix One: Further minor points to be addressed

- Paragraph 14 of section B highlights that NGG NTS is anticipating a decision from the Authority on its Gas Exit Capacity Substitution and Revision Methodology Statement. NGG NTS submitted its Gas Exit Capacity Substitution and Revision Methodology Statement to the Authority for approval on 4 January 2011. Ofgem issued a letter on 4 April 2011 which sets out the reasons for the Authority's decision to approve implementation of the methodology⁹. The ExCR should reflect this latest development as the obligations are effective from 1 July 2011.
- In paragraph 21, NGG NTS supplied an internet link to its website providing the level of NTS baseline exit flat capacity which is to be offered for sale. The link is to a letter dated 30 March 2010 and whilst it states the level NTS baseline exit flat capacity which is to be offered for sale it also states that the Gas Exit Capacity Substitution and Revision Methodology Statement has not been approved. This is no longer the case and it should be updated accordingly.
- Paragraphs 61 and 122 indicate that users will be able to commence capacity assignment of Enduring Annual NTS Exit (flat) Capacity from 1 August 2011. However, UNC modification proposal 0347V giving effect to this was approved on 12 April 2011; as a result users will be able to commence assignment of Enduring Annual NTS Exit (flat) Capacity from 1 June 2011. The ExCR should be updated accordingly.
- In paragraph 71 NGG NTS refer to "negative entitlements". NGG NTS has highlighted the concept of a negative capacity (this set out in UNC TPD B5.5), however the ExCR does not reference this nor does the term 'negative entitlement' feature in the UNC. We expect NGG NTS to provide additional clarification within the Statement in order to further understanding of this concept in advance of the document being published.
- A new addition to the ExCR is paragraph 37 which indicates that acquiring a revenue driver could be subject to NGG NTS' sole discretion. NGG NTS has used the term "sole discretion" in a number of places; we would expect NGG NTS to keep in mind its licence obligation to run an economic and efficient system when exercising any such discretion. An alternative wording might be more helpful in this context.
- Paragraph 77, 78 and 79 denote how NGG NTS will treat applications from users for reductions of their Registered Enduring Annual NTS Exit (Flat) Capacity at relevant NTS Exit Points in response to ad hoc invitations from NGG NTS. Paragraph 79 details the criteria to be used to identify which reduction requests should be accepted. It is appropriate that this is in the ExCR, however we cannot see a reason as to why it should not be included in the UNC. This would ensure that this criteria is open to review through the UNC modification process.

⁹<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?file=Exit%20substitution%20decision%20310311.pdf&refer=Networks/Trans/GasTransPolicy/ExitSub>