



*Promoting choice and
value to customers*

The Joint Office, Relevant Gas
Transporters and other interested
parties

Direct Dial: 020 7901 7050
Email: robert.hull@ofgem.gov.uk

18 October 2005

Dear Colleague,

National Grid NTS's application under the IECR to adjust investment lead times in respect of the release of incremental capacity in the 2005 QSEC auction

On 4 October, Ofgem issued its final decision letter on modification proposal 0036 under the Uniform Network Code (UNC) approving the implementation of this proposal as well as a related decision to approve changes to the Incremental Entry Capacity Release Methodology Statement (IECR) to introduce a formal consent process in respect of adjustments to investment lead times at entry terminals.¹ These decisions have provided the National Grid Gas National Transmission System business (referred to below as National Grid NTS) with a degree of flexibility to specify revised lead times for the delivery of any incremental capacity that is offered in the long term auctions, subject to Authority consent².

On 7 October 2005, National Grid NTS submitted to the Authority, a formal application for consent under its IECR to adjust investment lead times in respect of the release of incremental capacity in the 2005 QSEC auction at the Milford Haven and the Easington Aggregate System Entry Points (ASEPs). This followed the completion of an industry-wide consultation, by National Grid NTS, in respect of its proposed application to allow shippers and other interested parties to make representations.

Ofgem³ has considered the issues raised by National Grid NTS's formal applications and the views of respondents, and, having regard to the principal objective and statutory duties of the Authority⁴, has decided to consent to National Grid NTS's applications.

¹ UNC modification proposal 0036 'Limitation of incremental capacity offered in QSEC auctions', Ofgem, 4 October 2005 and 213/05 – 'Proposed amendment to the Incremental Entry Capacity Release (IECR) Methodology Statement to introduce a formal consent process to adjust investment lead times', Ofgem, 4 October 2005.

² Further background to modification proposal 0036 is found in the Ofgem decision letter.

³ Ofgem is the Office of the Gas and Electricity Markets Authority. The terms 'Ofgem' and 'the Authority' are used interchangeably in this letter.

⁴ Set out in Section 4AA of the Gas Act 1986, as amended.

National Grid NTS's consultation

On 21 September, National Grid NTS issued a consultation on its proposed application to the Authority for consent to adjust the investment lead times in the 2005 QSEC auction of entry capacity at:

- Milford Haven from the nominal 3 years to 4 years for release of *incremental* capacity above 125% of the NTS SO baseline from January 2009; and
- Easington from the nominal 3 years to 4 years for release of any *incremental* capacity beyond the NTS SO baseline.

In its consultation National Grid NTS stated:

- ◆ in respect of Milford Haven, that in order to deliver incremental capacity at 50% above the NTS SO baseline, it would be necessary to design and construct a duplicate of the connecting pipeline that is currently under construction to extend the NTS. In particular, National Grid NTS specified that there are a number of external factors beyond its control which affect the deliverability of such a project within three years relating to Environmental Impact Assessment regulations, planning permissions and easements from landowners; and
- ◆ in respect of Easington, that in order to deliver incremental capacity at 50% above the NTS SO baseline, it would be necessary to design and construct a "greenfield" compressor station and that its best estimate of the time required from auction gate closure to commercial availability of a greenfield compressor is approximately 44 months. In particular, National Grid NTS specified that there are a number of external factors beyond its control which affect the deliverability of such a project within three years including the planning consent process, the length of any public enquiry and land acquisition.

Furthermore, National Grid NTS stated that it was separately mindful that Ofgem must have regard to the potentially significant costs that shippers (and potentially customers) may be exposed to through capacity neutrality in the event of any buy back of capacity offered for sale and sold.

Respondents' views

National Grid NTS received three responses to its consultation, none of which were confidential.

One respondent commended the information provided and noted that this enabled a more realistic assessment of the implications of such restrictions.

This respondent stated that the standard for incremental capacity should remain at 150% of baseline level within 3 years, but acknowledged that this is not always possible. This respondent stated that there are two factors by which such applications for consent to limit the offer of incremental capacity should be judged:

- ◆ notice of such restriction must be in advance of the first offer for sale of that incremental capacity to provide visibility and transparency to the process; and
- ◆ the cause of the restriction must be outside the reasonable control of the

transporter.

With respect to Milford Haven, this respondent stated that, without further analysis of the impact of the factors causing difficulty, they cannot form a view as to the application of this restriction at the proposed level of 125% of baseline capacity.

With respect to Easington, this respondent stated that it is now commonly acknowledged throughout the industry that gas flows at Easington will increase in the future and noted that from the information provided, it is evident that any significant increase in capacity at Easington will require the provision of an additional compressor station on a greenfield site.

This respondent noted that National Grid NTS's case seemed to conform to both of the criteria stipulated above and concluded that the proposed limitation of incremental capacity at Easington for the gas year 2008/09 was not unreasonable.

Another respondent welcomed the level of transparency that National Grid Gas had adopted in its consultation, and offered qualified support for National Grid NTS's proposal stating that the forced release of incremental capacity, which National Grid NTS cannot deliver within the required timeframe due to factors outside its control, would not be in the interests of customers and would represent uneconomic and inefficient action.

However, this respondent expressed concern regarding the difficulties in delivering entry capacity at these two vital entry points, particularly given the tight supply/demand position for the two coming winters. This respondent therefore called on Ofgem and DTI to ensure that no actions by third parties are having a detrimental impact on the operation of the gas market or on the UK's security of supply position. This respondent also questioned the effectiveness of auctions in delivering clear market based signals to National Grid NTS.

Another respondent stated its initial view that the information presented by National Grid NTS is inadequate and it is unable to make an informed judgement as to whether or not this application is reasonable. This respondent stated that further information should be provided to the Authority providing details of the "significant" potential buy back costs involved. This respondent indicated that, without knowing whether the capacity would be allocated it was not possible for it to quantify the likely extent of buy back costs. This respondent also noted that National Grid NTS did not provide any indication of the materiality of the costs likely to be involved. The respondent also raised concerns regarding the fast track nature of the timetable under which National Grid Gas's application is being assessed.

National Grid NTS's formal application

On 7 October 2005, following consideration of respondents' views, National Grid NTS submitted its formal application, including the provision of certain confidential information. This application was substantively unchanged relative to the proposed application consulted upon on 21 September 2005⁵. However, National Grid NTS proposed the following adjustments to the incremental capacity it intends to offer for sale in excess of the SO baseline as set out in Table 1 below. This differed from the Table provided in its consultation, in that for Q4

⁵ The non-confidential elements of this formal application were circulated by the Joint Office on 12 October 2005.

of 2008 at Milford Haven, National Grid NTS had previously stated an amount of incremental capacity of 25% above the NTS SO baseline.

Table 1: Amount of Incremental Capacity above the NTS SO baseline proposed to be released in the 2005 QSEC auction at Milford Haven and Easington (expressed as percentage of the NTS SO baseline)

Quarter	Milford Haven	Easington
Q4 2008	50%*	0%
Q1 2009	25%	0%
Q2 2009	25%	0%
Q3 2009	25%	0%

* the baseline at Milford haven increases from 650GWh/d to 950GWh/day from January 2009.

Ofgem's decision

Ofgem has decided to consent to National Grid NTS's application, under the IECR, to adjust investment lead times in respect of the release of incremental capacity in the November 2005 QSEC auction as indicated in Table 1 above. In reaching this decision, Ofgem has considered National Grid NTS's formal application, the views expressed by respondents to National Grid NTS's consultation, and independent consultancy advice received on the technical, engineering aspects of National Grid NTS's application.

Assessment of applications

In respect of the Easington terminal, Ofgem accepts that it is likely that a new greenfield compressor would be needed to provide obligated incremental capacity in the Easington area should it be signalled through the long term auctions. In addition, having reviewed National Grid NTS's applications, Ofgem considers that it is unlikely that any such compressor can be delivered by National Grid NTS in a three year timescale particularly given existing planning and consents processes which are largely outside of the control of National Grid NTS.

Further, in respect of Milford Haven, Ofgem's engineering analysis suggests that there is a significant risk that levels of capacity above those outlined in Table 1 are not deliverable within a three year period due to the nature of the projects involved. In particular, the investment projects required to deliver this level of capacity represent significant undertakings with detailed planning and DTI approvals required.

In the light of these conclusions, Ofgem does not believe that it would be appropriate to place customers in a position where they may (depending on the nature of any contractual arrangements entered into with their respective shippers) be exposed to the costs of buying back obligated incremental entry capacity sold under a three year lead time which, on the basis of Ofgem's engineering assessments, is unlikely to be physically deliverable in this time.

On this basis, Ofgem believes that granting this consent is consistent with the Authority's statutory duties and the principal objective of the Authority to protect the interests of customers.

Going forward

It is important to reiterate the views expressed previously by Ofgem regarding the future of investment lead time consent processes. In particular, Ofgem would note that consideration will need to be given through the forthcoming transmission price control review process to the nature and timing of any consent process and the governance arrangements surrounding such a

process going forward. In addition, Ofgem believes that consideration should be given to other alternative solutions such as dispute resolution as part of the transmission price control review process and to the relationship of any such process to the timing of the long term auctions.

Ofgem also notes the concerns raised regarding the timetable for consideration of this consent application. In this respect, Ofgem considers that the issues raised by modification proposal 0036 which ultimately resulted in this application being raised, should have been brought forward at an earlier stage by National Grid NTS to facilitate a more timely consideration of the issues and the subsequent applications ahead of the long term auctions. In particular, as noted in Ofgem's decision letter of 4 October on the modifications to the IECR outlined above, we would encourage National Grid NTS to ensure that it brings forward any applications it may wish to make in a timely manner and well before the long term auctions.

If you wish to discuss any aspect of this letter, Mark Feather (telephone 0207 901 7437) would be pleased to assist.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Robert Hull', with a horizontal line underneath.

Robert Hull
Director, Transmission