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value to customers*

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2 December 2005

Dear Tim,

### **Development of a charging methodology and charging model for gas entry/exit reserve prices**

As discussed on previous occasions, one of the issues we are looking at as part of the current Transmission Price Control Review (TPCR) is the level of Ofgem involvement in the process of setting UCAs and the dual role which UCAs currently fulfil (i.e. as a revenue driver and as a basis for reserve prices in the entry capacity auctions).

We are actively considering an alternative model under which UCAs and reserve prices would be de-coupled with National Grid Gas, in addition to the methodology, being responsible for setting reserve prices or charges (as appropriate) for new and existing gas entry and exit points from April 2007 onwards. This de-coupling would put the gas charging regime on a more equal footing with the electricity charging regime, with reserve prices calculated by National Grid Gas rather than being subject to an Ofgem UCA licence consultation. Under this model, Ofgem would have to approve the methodology in the first instance and on a regular basis thereafter (say, annually), and would have the right of veto over any subsequent proposed methodology changes. Prices pursuant to the methodology would be updated annually.

The development and consultation on a new de-coupled reserve pricing methodology would need to take account of the issues raised during Ofgem's recent consultations in this area.

The consultation on whether to pursue such an alternative model will form part of the forthcoming Second TPCR Consultation scheduled for December 2005 with a policy decision anticipated in the Third TPCR document scheduled for March 2006.

Recognising that the process of reviewing the reserve pricing regime will be complex and might involve the development or purchase of a new network model, we believe it would be desirable for National Grid Gas to start this work as soon as possible given an envisaged April 2007 implementation date for approval of the tariff methodology. When charges pursuant to this methodology would come into place would need further consideration.

We recognise that there might be some costs attached to the development of a new network model or the purchase of an off-the-shelf network model. It seems sensible that such a model would be suitable both for entry and exit points and for small as well as large flow increments. Also, for transparency reasons it would be highly desirable for a populated model to be freely available in the public domain.

I would be happy to discuss these issues in more detail.

Yours sincerely

A handwritten signature in black ink, appearing to read 'David Gray', with a stylized flourish at the end.

David Gray

**Managing Director, Networks**