

Bob Hull
Director, Transmission
Ofgem
9 Millbank
London
SW1P 3GE

Phil Lawton
Distribution Regulation Manager

Phil.lawton@uk.ngrid.com
Direct tel +44 (0)01926 656448
Direct fax +44 (0)01926 656520

www.nationalgrid.com

30 January 2006

Dear Bob,

Response to Second Consultation

The second consultation on the transmission price control review, in addition to discussing issues affecting the revenues required to fund transmission activities, also invites views on various models for reform of the NTS exit arrangements. This response is on behalf of National Grid's distribution business and comments on these latter issues.

The models for exit reform described in chapter 7 appear to be derived from the work done during the network sales process. We believe that the implementation of the enduring arrangements for NTS exit is fundamental to ensuring the efficient allocation of investment between the transmission and distribution networks, and therefore it would be appropriate for consideration to start from the question of what problems exist with the transitional arrangements. Such an approach would have the following advantages:

- The experience gained from the implementation and early running of the interim arrangements can be factored into the design of a solution. This would allow a broader review of product definitions, allocation methods and monitoring of outturn, in addition to the zonal/nodal issues covered by the current consultation.
- By adopting a starting point of identifying the problems with the transitional regime and asking the working group to design a solution there would be a greater chance of reaching an industry consensus.
- We do not believe that the current models Ex2, Ex3, Ex3A and Ex4 are sufficiently well defined or understood by the industry for respondents to make an informed choice between them, or identify the cost implications of the various models. Some of the areas where we believe further clarity is needed are discussed below.

From our understanding, the nodal/zonal issue is problematic for both product definition and allocation of baselines. The adoption of a nodal definition for exit products leaves the DN vulnerable to flows being switched between offtakes. This commonly happens with outages at offtakes where the network is designed to maintain supplies by increasing the flow through nearby offtakes. Should a DN be penalised for the system coping with an outage/fault in the way it was intended to? Conversely, if this issue is addressed by granting DNs exit capacity on a zonal basis, then the NTS could, in theory, be faced with a demand to use all the exit capacity at the most remote point within the zone. The NTS could cover themselves against this problem by either "over engineering" the system, or artificially

reducing the volume of exit rights to allow the existing system to cope with all the gas being taken at the most remote point. Neither of these is an efficient outcome.

If the NTS is given baselines on a zonal or global basis and then asked to allocate capacity to individual offtakes or groups of offtakes, it is not clear how this will be done on a transparent and equitable basis. To do so when capacity is a scarce quantity would require a methodology for linking any investment in the network to one or more requests for capacity that could be hundreds of miles away. Achieving this in a demonstrably fair way with participants making simultaneous bids via an auction process would be a significant challenge.

Finally, there is some debate within the industry around the definition of flow flexibility. One of our concerns is that the current product definition assumes a uniform availability throughout the year. However, in reality at times of low demand greater levels of flow flexibility could be accommodated than on peak. There is a risk of creating perverse incentives if the product definition is not matched to the behaviour of the system.

To summarise, it is our view that it would be appropriate to ask the enduring exit working group to review the transitional regime, identify any defects and then design potential solutions. National Grid distribution is committed to contributing to the development of the NTS exit arrangements through Ofgem's working group and would be pleased to take part in this process.

If you wish to discuss any of these comments any further, please do not hesitate to contact me.

Yours sincerely

By Email

Phil Lawton
Distribution Regulation Manager