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Dear Bob,

Response to Third TPCR Consultation

The third consultation on the transmission price control review, in addition to discussing issues affecting the revenues required to fund transmission activities, also invites views on the reform of the NTS exit arrangements. This response is on behalf of National Grid's distribution business and comments on these latter issues. In addition to answering the relevant questions in appendix 12, we have expanded on some of our key concerns below.

We understand that the primary objectives of NTS exit reform are to ensure that all parties using the NTS are treated on an equitable basis and to facilitate efficient investment across the wider network. We support both these aims. We are also aware of the risk that exit reform could have unintended and undesirable consequences. For example, if the operational flow swaps between offtakes that currently utilise the flexibility available off peak are no longer possible, then DNs may be faced with a choice between incurring significant penalties or triggering inefficient investment. Alternatively, the detailed drafting of the rules could create gaming opportunities. In our comments we have concentrated on those areas where we believe that there is a risk of such unintended consequences.

User Commitment

As explained in our answer to question A12.10, we have the following concerns with user commitment:

- User commitment is only appropriate to very large consumers whose individual decisions have a significant impact on the gas infrastructure. Most growth results from either the connection of additional smaller loads, or general load growth amongst smaller users. We estimate that of the demand supplied by DNs, only around 10% of User commitment to increased capacity will actually be borne by large Users, the remaining 90% will be borne by the DNs.
- As we have noted previously, even where DNs are able to link additional capacity to an end user via an ARCA, there is still a residual risk. For example, a DN reserves capacity on behalf of factory A who signs an ARCA. In the event factory A takes the additional demand but factory B closes negating the need for the additional NTS exit capacity. The DN is committed to the capacity, but cannot pass on the costs.

Use of Nodal Definition for Access Rights

As described in our replies to Ofgem's questions, from time to time it is necessary to switch gas between offtakes for operational reasons. NTS exit reform is designed to ensure efficient investment in the wider gas network. For this to be achieved, it is essential that gas transporters cooperate to

manage operational issues without the requirement for DNs to "overbook" capacity, which would lead to inefficient investment. Given that these flow swaps can be required repeatedly and at short notice, the proposed substitution mechanism (which we understand to operate on an annual basis) would not be suitable and something more flexible is necessary. Therefore DNs will still need the ability to execute flow swaps in operational timescales. Accordingly, we welcome and support Ofgem's reference to maintaining the current "flow swapping" agreements in the guidance notes issued with the questionnaire associated with the regulatory impact assessment.

Flow Flexibility

We support the concept of users being able to convert flat capacity into flow flexibility capacity (Flow Flex) and vice versa. Logically, as the flow of gas reduces from the peak values, there must be "spare capacity" that could be used to provide more flexibility and this additional flexibility should be made available to users. Clearly, any regime that does not recognise and provide access to all available flexibility/storage will compromise the efficient operation and development of the wider system.

In a broader context, we have several other concerns around the Flow Flexibility product:

- The present definition of Flow Flex captures any difference between the volume of gas offtaken between 0600 – 2200 and the volume that would have been taken if gas was taken at a uniform rate across the day. This captures factors that are unrelated to the utilisation of NTS storage:
    - Forecast demand changing within the day (this is particularly important as the DN is subject to conflicting obligations: to balance its network on the one hand and not to exceed Flow Flex bookings on the other. If a DN seeks to minimise its Flow Flex liabilities by allowing its end of day stock levels to rise, then this will undermine the national balancing as the DN is in effect "hiding" the imbalance on its network)
    - Equipment failure or maintenance altering gas flows
    - Flow swapping at NTS request
- How will NTS directly connected customers respond to the obligation to purchase Flow Flex? A party with a continuous process could feel obliged to purchase sufficient Flow Flex to cover them for tripping at 2200 hours. As parties purchase Flow Flex to cover for rare events, this will artificially drive up the demand, creating a shortage and increasing costs. However, there will be no increase in the level of variability seen on the system from today. (An analogy can be drawn with electricity where frequency response and short term reserve are provided centrally, rather than requiring each generator to provide cover for the risk of its own plant tripping).

We recognise that these comments bring into question the definition of the Flow Flex product. One approach that may be worth investigating would be to develop a definition of Flow Flex that distinguishes between planned utilisation of NTS storage and unplanned operational events (forecast errors, plant failures, agreed flow swaps etc.). For example, Flow Flex utilisation could be based upon the first, i.e. planned, Offtake Profile Notification of the gas day. Subsequent changes to the Offtake Profile Notification (within day) would be considered to have been driven by "operational events" and hence would not increase the level of Flow Flex utilised. However, the party concerned could be required to explain the operational reasons behind any increase in flow variation imposed upon the NTS.

Length of Commitment

In our view it is appropriate to require a longer commitment where the additional capacity will trigger investment. The shorter commitment would then apply to either maintaining an existing capacity booking or increasing a booking, but only to use existing capacity. This reflects the fact that there is no new risk to the NTS associated with allocating existing capacity as the costs are already sunk. We are concerned that under the existing proposals, a party that reduced its capacity could only return to

its previous level of prevailing capacity rights by entering into a longer commitment regardless of whether investment is actually required. Such a regime will encourage parties to hoard capacity rather than releasing it for other participants to use. Furthermore, a user seeking to delay closure (possibly a power station in response to a perceived shortage of generation) could only do so by entering into a longer term commitment or relying on access to shorter term constrained capacity, regardless of whether any investment was required. It is conceivable that this commitment could lead to the closure of a large user that would otherwise be economically viable – even though the required exit capacity existed and no other parties were interested in using it.

When the detailed rules are drafted, it will be important to check whether they can be "gamed". For example, it would be undesirable for a company to be able to limit its commitments by booking capacity in alternate years.

Interaction of NTS and DN Interruption Regimes

When the NTS want to "buy-back" rights, one route is to use the interruptions regime. Where the party to be interrupted is connected to a DN, the NTS must access this interruption via the DN. (The DN may already have contracts to interrupt as an alternative to booking NTS exit rights, in which case it is clearly double accounting if the NTS were to contract to "buy-back" the rights from the same end user). This raises two questions:

- Should the DNs allow for NTS requirements when contracting for their own interruption or should this be a separate process? and
- How will the payment flows between the NTS and DNs operate?

Alterations to Cash Flows

We welcome the pragmatic proposal to delay the alteration of the cash flows to "Option 2A". This will enable us to make a single change to our systems covering both the move to the enduring arrangements and the changed cash flows. Clearly, this will be more efficient than making the two changes separately.

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

Responses to Ofgem's Questions in Appendix 12 of the 3rd TPCR Consultation

A12.1 – Do you agree that for the period from 1 April 2007 to 30 September 2010, baselines should:
not be specified for interruptible capacity? We agree that the release of interruptible capacity in this period should be at the discretion of the NTS.
not be specified for GDN flexibility? We have already booked flexibility up to 2008/9. If the availability of flexibility is to be reduced, it is essential that we are given sufficient notice to permit investment within our network. Accordingly, we believe that the level of flexibility made available in 2009/10 should be at least equal to that booked in 2008/09.

be at the same level and degree of aggregation as during the enduring period (i.e., nodal and based upon the practical maximum physical capacity)?
Whilst we understand that the nodal definition of rights gives the NTS a level of certainty not provided by the other options, it creates a potential problem for DNs. From time to time the flow of gas is swapped between offtakes to release plant for maintenance, following a trip, to facilitate pigging runs, to assist the NTS etc. Away from peak demand, there is a level of flexibility within the NTS and DNs that can be managed to meet these needs. This is not a problem under the Transitional Regime, where bookings are treated as planning data and access to flexibility capacity for operational reasons is not penalised, but a solution will be required for the enduring arrangements.

Questions A12.2 – A12.8. We are restricting our comments to DN aspects of NTS exit reform.

A12.10 – Do you agree that our emphasis on user commitment is appropriate? We support user commitment for large gas users whose individual decisions have a significant impact upon the gas infrastructure. However, the vast majority of DN load growth is driven by changes relating to smaller users (either the connection of new loads or load growth amongst existing users) where the concept of user commitment is inappropriate. Under these circumstances the proposed model will result in "Distributor Commitment" rather than the proposed "User Commitment".

A12.11 Do you agree with our assessment of the high level options in the Second Consultation?
a) Do you agree that the NTS exit capacity products should be specified on a nodal basis?
Whilst we understand that the nodal definition of rights gives the NTS a level of certainty not provided by the other options, it creates a potential problem for DNs. From time to time the flow of gas is swapped between offtakes to release plant for maintenance, following a trip, to facilitate pigging runs, to assist the NTS etc. Away from peak demand, there is a level of flexibility within the NTS and DNs that can be managed to meet these needs. Under the enduring regime a mechanism is essential to provide access to this flexibility to avoid either forcing DNs to book additional capacity (i.e. inefficient investment) or imposing penalties on DNs for non-standard, but routine operations. Accordingly, we welcome Ofgem's comment in "Assumptions for high level options for enduring Offtake" that "it is assumed that the transfer of capacity between interdependent nodes which are owned by a single party such as a GDN may also be possible in line with the current 'flow swapping' agreements".
b) Do you agree that baselines should be specified on a nodal basis? Exit rights and baselines should be specified on the same basis – if exit rights need to be nodal, then so do baselines.

Questions A12.11(c) to A12.14. We are restricting our comments to DN aspects of NTS exit reform.

A12.15 – Do you believe that the level of baselines should be determined in accordance with the practical maximum physical capacity of the network?
We agree that the practical maximum physical capacity of the network is the most appropriate measure of the capacity that the NTS is able to deliver operationally.

Questions A12.16 to A12.22. We are restricting our comments to DN aspects of NTS exit reform.

A12.23 – Do you agree that the implementation of the "Option 2A" approach to payment flows should be postponed such that it coincides with the implementation of the enduring regime?
We agree that the timing of the move to "Option 2A" cash flows should be aligned with the introduction of the enduring regime. Introducing "Option 2A" cash flows earlier would require National Grid to amend our systems dealing under the Transitional regime, incurring significant costs for little benefit.