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16th August 2006

Dear Indra,

Response to Consultation on New Entry Arrangements for Connecting to the Gas Distribution Network

As we indicated in our previous response to chapter five, we believe that the proposed interim arrangements (that are now the subject of a UNC modification proposal) can form the basis of the enduring arrangements. The main difference is that the proposed interim arrangements provide for only interruptible capacity and not firm. Incorporating firm capacity will require a more rigorous assessment of the level of capacity that can be delivered and a mechanism for providing compensation when the capacity is not available. As you discuss in the consultation consideration also must be given to ensuring that GDNs make entry capacity available on a non-discriminatory basis. Whilst we agree that Gas Transporters should not discriminate unduly between connected parties, we believe that this should be achieved by making the minimum necessary changes to the GDN licences.

Our detailed comments on the consultation are provided below. The responses to your specific questions are in the appendix.

Provision of Firm Capacity

GDNs were designed to receive gas at specific locations only, for example NTS Offtakes or boil off from LNG sites. The introduction of gas into a DN can cause the following technical problems:

- The volume of gas introduced could exceed the local demand, especially overnight. As gas cannot be transferred from the DN into the NTS, at any time the flow of gas onto the network must not exceed the demand in that section of network. It is important to recognise that gas must be injected into the network in a controlled manner reflecting the level of demand and storage within that part of the network. If there is a shortfall of injection early during the day that has to be replaced with gas from the NTS, then the entry point cannot "make up" this volume later during the day. Whilst such a constraint could be relieved by linking together sections of the DN to increase the volume of demand available, such work is likely to be expensive with a significant lead time.
- Clearly, gas will only flow onto the system if its pressure exceeds that of the gas within the network. If the party bringing gas on to the system imposes constraints onto how the network is operated, for example limiting the highest pressure of the local system, the DN should be

compensated for any loss of capacity or line-pack. (See also bullet point below referring to purchase of “flow flexibility”.) Alternatively, the connected party could install compression to avoid restricting the operation of the DN.

- Calorific Value (CV) shrinkage and other gas quality issues. If the gas injected has a CV significantly lower than that of the NTS gas, it will cap the chargeable CV of the gas in that part of the network. This would impose costs upon the NTS who pay for CV shrinkage and lower the chargeable amount of gas passing through the DN, thus reducing transportation revenues. Given that a DN entry point can be expected to be small, the economic solution is probably for the party injecting the gas to raise the CV of the gas by blending prior to injecting the gas into the network. The alternative solution of the connected party compensating both the NTS for CV shrinkage and the GDN for loss of transportation revenue would be complex and, in most cases expensive. Equally, other problems with the gas quality may need to be resolved through pre-treating the gas to make it compliant prior to its entry to the DN.
- If the gas entering the system is not sufficiently odourised, this will either limit the volume of gas that can be injected or require additional plant to be installed and operated. Again, we believe any such additional costs should be met by the party bringing the gas onto the system.
- Additional requirement for flexibility from the NTS. If the party injecting the gas wishes to specify flow rates that are not constant or can be varied within the gas day, this will increase the amount of “flow flexibility” that the DN needs to purchase from the NTS. Alternatively, the operating regime at the site may restrict the operating pressure on the DN, preventing the full exploitation of line-pack within the DN and requiring additional flow flexibility from the NTS. We support Ofgem’s initial view that such costs should be paid by the connected party.

Whilst, not all of these issues will apply in all cases, the bilateral contract will need to identify the relevant issues, how they will be resolved and who will pay any costs incurred.

In each individual case, the DN will be able to estimate the volume of gas that can be accepted via a simple connection to the system. If the connecting party wishes to export a greater volume of gas the DN can provide options for physical works/contractual arrangements to facilitate this. It should be noted that for small volumes of gas entering the system it may be difficult to establish the business case for significant investment on the network and the scheme may only be economic if it operates within the capacity that is available via a simple connection.

Compensation When Firm Capacity is not Available

Should the DN be unable to accept gas in accordance with the firm capacity that has been sold, compensation for the connected party should be paid. Given the local nature of these arrangements, there will generally be only one party able to sell back capacity and they would enjoy a monopoly in any auction process. In our view it would be appropriate to define the compensation arrangements as part of agreeing the contractual terms to avoid the problems of setting a price between a monopoly vendor and a monopoly purchaser.

Non-discrimination

It is important to achieve a balance between the need to ensure DNs do not discriminate unduly between customers and creating a regime that is flexible enough to allow DNs and customers the freedom to negotiate to make the best use of local system conditions. Furthermore, on the basis that additional licence conditions will impose costs on to the GDN in monitoring/demonstrating compliance, we would argue for new licence conditions to be kept to a minimum. We believe that this balance can be achieved by:

- Setting out the main principles and responsibilities in the UNC
- Extending the Charging Methodology to cover DN gas entry
- Enabling a new GDN entry point to request Ofgem to determine GDN entry arrangements when agreement cannot be reached with the GDN

- Requiring the GDN to offer GDN entry arrangements in accordance with any determination by Ofgem

The final two bullet points will remove any incentive on a GDN to behave in an unreasonable manner, e.g. refusing to engage with a potential entry point, as this would inevitably lead to a referral to Ofgem who would not support the unreasonable stance.

Apportioning available entry capacity

Whilst determining the available entry capacity requires a detailed knowledge of the local system, the same is not true of apportioning capacity. As this work could be done by parties other than the GDN, it would not be appropriate to include it within the licence and any agreement between the GDN and connected party should be negotiated bilaterally.

Transportation charging arrangements

We agree that it will be necessary to develop a charging regime for gas entering a GDN. As most parties have indicated a desire to be able to trade gas injected into a GDN, we suggest that GDN entry capacity/charging should be priced to include an element to cover access to the NBP.

In terms of how such revenue should be treated, we support the hybrid option where transportation and connection revenue would be included in the price control with any contributions being treated as excluded revenue. This would maintain a parallel between the arrangements for entry and exit connections.

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 Specific Questions

Chapter 3

1. **Is a modification of the GDN's GTs' licence the best way for Ofgem to implement a contractual approach for new commercial and regulatory arrangements for GDN entry points?** In our view it is important that the new arrangements avoid restricting the ability of the GDN and connected party to achieve a mutually acceptable outcome. As set out in the covering letter, we see this being achieved by,
 - Setting out the main principles and responsibilities in the UNC
 - Extending the Charging Methodology to cover GDN gas entry
 - Enabling a new GDN entry point to request Ofgem to determine GDN entry arrangements when agreement cannot be reached with the GDN
 - Requiring the GDN to offer GDN entry arrangements in accordance with any determination by Ofgem

The knowledge that the connecting party can request a determination would ensure that the GDN engaged actively and acted reasonably. In this way there would be no need for the commercial terms and conditions to be published as this could artificially restrict the negotiation. For example, the GDN/connected party could agree terms for the storage being made available for use as diurnal storage by the GDN. As described in our main response, additional licence conditions impose costs on to a GDN in terms of monitoring/demonstrating compliance, and hence, in our view, should be kept to the minimum necessary.
2. **What are the views of interested parties about the key issues relevant to GDN entry arrangements?** We consider the key issues to be:
 - Determining the entry capacity available via a simple connection
 - Agreeing the physical work/contractual arrangements required to deliver the requested volume of entry rights
 - What provisions apply when firm capacity cannot be made available
 - How it is ensured that GDNs will make capacity available on a non-discriminatory basis
3. **Are there any further key issues not discussed in this chapter that should be considered?** The consultation does not describe what the "buy-back" arrangements would be for firm capacity. We believe that an auction would be inappropriate given that there would often be only one counter party bidding. To avoid such a monopoly, we propose that the contract should contain an agreed buy-back arrangements.

Chapter 4

1. **Is there any reason why the three existing GDN entry points should not in due course have the same commercial and regulatory arrangements as new GDN entry points?**

From a non-discrimination point of view, it is clearly desirable for new and existing DN entry points to operate under the same arrangements. If the new regime developed for DN entry is more attractive than the current "deemed NTS entry" model, there is no reason why this should not happen. We think that this outcome is likely as the connected party would avoid paying NTS entry charges. However, if the current DN entry points do decide that their present "deemed NTS entry" model is more attractive than the new proposals, then Ofgem will have to decide whether it is more important to achieve non-discrimination between connected parties or to preserve existing entry rights.
2. **How should a timely transition to the new arrangements be facilitated while preserving existing entry capacity rights?** As discussed above, this will only be an issue if those with existing entry rights wish to remain on their present arrangements rather than migrating to the new arrangements. Under these circumstances a choice will need to be made between the benefits of all parties operating on the same arrangements and the preservation of existing entry capacity rights.

Chapter 5: response already made on 21 July 2006.