

## Entry arrangements for connecting to the gas distribution network

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### Overview:

This document sets out Ofgem's decision on the long term commercial and regulatory framework for entering gas into the distribution network. The new arrangements will be based on a contractual approach between new GDN entry points and the relevant Gas Distribution Network (GDN), and will be implemented through a modification to the GDN's Gas Transporters' licence. The new licence condition will include key principles that a GDN must comply with when offering terms to GDN entry points for entering gas into its network and the ability for GDN entry points to seek a determination from Ofgem. The new arrangements are to take effect from October 2007.

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## Context

This document sets out Ofgem's decision for the long term commercial and regulatory framework for entering gas into the distribution network, and follows on from the consultation document Ofgem published in July 2006.

Ofgem is proposing that the new arrangements would take effect from 1 October 2007. However, Ofgem would expect the Gas Distribution Networks (GDNs) to offer terms to new GDN entry points prior to this date so that a new GDN entry point could have in place an arrangement for entering gas onto the system from 1 October 2007. If the GDNs accept the proposed licence modification when it is formally consulted on, Ofgem would expect to be able to modify the GDNs' licences by the beginning of April 2007, at which point discussions between GDNs and GDN entry points could commence.

There are currently three GDN entry points that are subject to the same arrangements as NTS entry points, with NGG NTS selling the entry capacity, and the GDN facilitating the physical flows of gas. Ofgem is aware of two possible new GDN entry points, and with a number of storage and LNG projects being considered, it is possible that there will be additional new GDN entry points in the future.

Ofgem considers the new arrangements to be proportionate given the small number of current and expected GDN entry points and the quantity of gas flowing through these GDN entry points. If there was a significant increase in the number of GDN entry points it might be appropriate to re-consider the regulatory framework.

## Associated Documents

- Gas Transmission - New NTS entry points, reserve prices in auctions and unit cost allowances (UCAs), Consultation Document – May 2005  
<http://www.ofgem.gov.uk/ofgem/work/index.jsp?section=/areasofwork/transcopricecontrolreview>
- New entry arrangements for connecting to the gas distribution network, Consultation Document - July 2006  
[http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/15659\\_11606.pdf?wtfro m=/ofgem/work/index.jsp&section=/areasofwork/gasdistpol](http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/15659_11606.pdf?wtfro m=/ofgem/work/index.jsp&section=/areasofwork/gasdistpol)

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## Summary

### Introduction

This document sets out Ofgem's decision for the long term commercial and regulatory framework for entering gas into the distribution network. The arrangements will be based on a contractual approach between the GDN entry point and relevant GDN.

### New licence condition

Ofgem is proposing that the new arrangements be implemented through a modification to the GDN's Gas Transporters' (GT) licence. A draft of the proposed new licence condition is contained in Appendix 2. The licence condition would contain key principles that the GDN would be required to comply with when offering terms for entering gas into its network. It will also give Ofgem the ability to determine substantive parts of the offer or the variation to the ensuing agreement, if the parties cannot agree. The new standard special licence condition will:

- require GDNs to engage in negotiations on entry arrangements upon application from a potential GDN entry point;
- require GDNs to offer terms on a non-discriminatory basis;
- require GDNs to offer the GDN entry point the maximum level of available entry capacity, although the GDN entry point could request and accept less entry capacity;
- require GDNs to publish the main terms and conditions they agree with GDN entry points, subject to respecting the commercial confidentiality of the GDN entry point;
- enable a GDN entry point or GDN to request Ofgem to determine GDN entry arrangements when the terms of an offer for an entry agreement cannot be reached and when a dispute arises over a variation of the terms of an existing entry agreement; and
- require GDNs to offer entry arrangements in accordance with any determination made by Ofgem.

### Key issues

In this document Ofgem has provided some guidance about other issues not covered in the licence condition and the process Ofgem would expect to follow if it is asked to determine GDN entry arrangements. Among the key points noted by Ofgem are:

- **Apportioning entry capacity** - It will be for the GDN entry point to decide, consistent with any other statutory requirements, how to apportion the capacity

between shippers. The GDN entry point could reach agreement with the GDN for the GDN to carry out this function on its behalf;

- **Transportation charging arrangements** - Each GDN with an entry point will need to submit a charging methodology proposal to Ofgem for approval, following consultation in accordance with existing licence provisions. Ofgem would expect the GDNs to work together to develop a consistent methodology;
- **Revenue recovery** - Any transportation revenue obtained from entering gas into the distribution network would be included in the GDN's price control and connection revenue would be treated as an excluded service. Any contribution received towards the costs of reinforcing an entry point would be treated as excluded revenue and would not go into the price control;
- **Operational issues** - Ofgem would not object to the GDNs proposing a standard set of operational terms, similar to the Storage Connection Agreement, providing GDNs were prepared to consider reasonable requests for amendments where the standard terms did not fit the requirements of the entry point; and
- **Access to the wholesale market at the NBP** - Ofgem supports gas entered into the distribution network being able to trade at the National Balancing Point (NBP). This is currently facilitated through the Unified Network Code (UNC), and it will be for relevant parties to consider whether any UNC modifications are required.

## Existing GDN entry points

Consistent with our initial thoughts, Ofgem considers that the new arrangements should in due course apply to all GDN entry points. This includes the three existing GDN entry points at Hatfield Moor, Wytch Farm and the Isle of Grain that are currently deemed to be NTS entry points, and the Holford entry point that was granted interruptible GDN entry rights on an interim basis for one year in October 2006. With the exception of Holford, if the sites have not migrated voluntarily to the new arrangements by the end of the next transmission price control, Ofgem will consider again whether migration should be mandated.

## Next steps

This document includes a draft of the proposed new standard special licence condition that would be required to implement the entry arrangements in Appendix 2. Comments are invited by 10 February 2007. Pending comments, a Notice under Standard Special Condition D2 of the Gas Transporters' licence to modify the gas transporters' licence will be published shortly afterwards. Subject to the outcome of this consultation, the new licence condition will be introduced and GDNs will be obliged to enter into negotiations for an entry agreement on application from a GDN entry point from 1 April 2007 onwards. Ofgem would expect the GDNs to offer terms so that a new GDN entry point could have in place an arrangement for entering gas from 1 October 2007.

## 1. Summary of responses

### Chapter summary

This chapter summarises respondents' views on the issues raised in Ofgem's July 2006 consultation document on the long term arrangements for GDN entry points connecting to the gas distribution network.

### Introduction

1.1. Ofgem received 11 responses to the consultation document on long term entry arrangements for GDN entry points. The questions were summarised in Appendix 2 of the consultation. Responses were received from a range of industry participants including gas transporters, gas shippers/ suppliers and gas storage operators. All of the responses were marked non-confidential and can be viewed on Ofgem's website under the Gas Distribution Policy area of work.

1.2. Ofgem invited views from respondents to the specific questions set out in the consultation. Their comments are set out below.

### **Is a modification of the GDN's Gas Transporters' licence the best way for Ofgem to implement a contractual approach for new commercial and regulatory arrangements for GDN entry points?**

#### **Ofgem's initial thoughts**

1.3. Ofgem considered that the new arrangements would be best introduced by a modification to the GT licence. In reaching this view, Ofgem did not consider that the use of existing dispute resolution mechanisms in either the Gas Act 1986 or EU Directive 2003/55/EC offered a suitable means to settle disputes potentially arising under the new arrangements. In considering the principles GDNs should adhere to when entering into entry arrangements, Ofgem invited views as to whether there should be further requirements included in the GDN licence beyond the one for GDNs to offer terms on a non-discriminatory basis. Ofgem also stated that it did not expect to determine minor issues or detailed operational issues.

#### **Respondents' views**

1.4. The majority of respondents agreed that the licence condition formed the most suitable vehicle for implementing the contractual approach. It was judged by those who commented to be a better mechanism for giving Ofgem the requisite powers to intervene and determine disputes, than the two alternative options set out in the

consultation. Some respondents wanted the licence condition to also allow the GDN the same rights as a GDN entry point in being able to seek a determination from Ofgem. Respondents also agreed that Ofgem should not concern itself with minor points of disagreement, while two respondents added that the licence should stop short of listing the issues that Ofgem would determine on.

1.5. There was consensus that the principle of non-discrimination should be included as a key principle in the licence condition, among those respondents who supported the licence condition approach. A number of these respondents wanted the licence to encompass additional principles beyond non-discrimination. The best supported additional principles were a requirement to recognise that flows entering the distribution network should have access to the NBP, the requirement for GDNs to make available the maximum level of capacity, and the requirement to develop and publish a methodology by which the maximum level of capacity is determined. The requirement to have cost reflective charges in the licence was supported by one respondent.

1.6. One respondent, who was in favour of the licence modification argued against further requirements being included in the licence beyond that proposed by Ofgem. It was viewed that any further detail could restrict the GDN's ability to negotiate an appropriate bilateral agreement.

1.7. Two respondents did not consider it necessary to modify the GDNs' licence. One respondent considered the requirement for the GDN not to discriminate was sufficiently covered in the existing licence, while it also believed that the necessary arrangements governing entry were already in place, i.e. Network Entry Agreement (NEA) and Advanced Reservation of Capacity Agreements (ARCAs). The perceived additional costs and burden to the GDNs of monitoring and complying with the licence was cited as another reason against a licence modification. It was suggested instead that the UNC be used as an alternative vehicle for setting out the main principles and responsibilities.

1.8. Only one respondent opposed the introduction of bilateral arrangements between GDNs and GDN entry points. Its view was that such arrangements could be open to potential abuse, which could lead to smearing of costs to other industry players. This view was largely based on the respondent's assumption that the terms of the bilateral agreement would not be transparent.

## **What are the views of interested parties about the key issues relevant to GDN entry arrangements?**

### **Ofgem's initial thoughts**

1.9. Views were invited on the key issues Ofgem identified as requiring consideration in order to implement the contractual approach, and whether they should be addressed within the licence. These included maximum available entry capacity, the

allocation of entry capacity, charging arrangements, the treatment of GDN revenue, operational issues and ability to trade gas at the NBP.

## **Respondents' views**

### *Maximum available entry capacity*

1.10. A large number of respondents agreed that GDNs should be obliged to provide the maximum level of capacity available without the need to reinforce the network. Support was also expressed by some respondents for the GDNs to publish a methodology determining the maximum level of capacity. For the provision of additional entry capacity, respondents stated that this should be provided on either an interruptible basis or a firm one, with the latter secured by network investment, if necessary. It was agreed that the costs of providing entry reinforcement should be addressed in the same manner as other customer driven reinforcement, with two of the respondents noting that this could be achieved through an ARCA in addition to a capital contribution.

1.11. A couple of respondents opposed buy back rights in the event that a GDN could not guarantee entering gas having sold firm capacity. A preference was expressed instead for having a compensation payment defined in the agreement that would avoid the potentially high costs to GDNs from auctioning buy back rights to a potential monopoly bidder. An alternative approach based on defining a compensation payment up front as part of the contractual agreement was put forward as being more suitable.

### *Apportioning available entry capacity*

1.12. It was agreed by the few respondents that commented on this issue, that if the GDN takes responsibility for allocating entry capacity, the costs of doing so should be bilaterally agreed and then subsequently reflected when setting charges.

### *Transportation charging arrangements*

1.13. The commonly held view was that the provision of firm capacity should incur entry capacity and commodity charges. There was less agreement however, as to the terms of payment with regard to the provision of interruptible capacity. Ofgem's initial view that interruptible capacity should only incur commodity charges was queried by one respondent, who considered that as an interruptible entry point was likely to utilise firm capacity most of the time it was only appropriate that capacity charges be paid too. An additional charge to cover NBP access for trading gas was also proposed by another respondent. The principles of cost reflective and non discriminatory charges were considered to be suitably addressed by the majority of respondents in the existing GDN licence. Only one respondent believed that the requirement for cost reflective charges should be included in the new licence.

*Revenue recovery*

1.14. Responses to the treatment of transportation and connection revenue considered that new GDN entry points should be treated in a manner consistent with exit points. Therefore, the hybrid approach - transportation revenue is included in the price control and connection revenue and reinforcement contributions from the GDN entry point are treated as excluded revenue – was deemed the most suitable option.

*Operational issues*

1.15. Those respondents that commented on this issue agreed that operational issues for entry arrangements could use existing agreements such as the NEA and Storage Connection Agreement (SCA) as a suitable framework for discussions between the GDN and the GDN entry point.

*Access to the wholesale market at the NBP*

1.16. Respondents broadly supported the notion that gas entering the GDN should be able to trade at the NBP. Facilitating the entry of GDN entry points and avoiding perverse incentives to connect to the NTS in order to gain NBP access were cited amongst others, as good reasons to allow GDN entry flows to trade at the NBP.

**Are there any further key issues not discussed in this document that should be considered?****Ofgem's initial thoughts**

1.17. Ofgem did not provide an initial view on this issue.

**Respondent's views**

1.18. This question prompted respondents to put forward a number of varied issues that they wanted to be considered as part of the consultation. The main points being:

- the requirement to be able to assess the suitability of the arrangements should the number of GDN entry points exceed expectations;
- further clarity was requested from Ofgem on whether the terms of the contract should be consistent across all GDNs. While the respondents who raised this issue believed that the detailed terms for each specific entry point would differ, it supported some commonality for the high level terms. This, it believed would facilitate transparency and avoid incentives to connect to one GDN over another.

One of the respondents went further by suggesting that developing a generic form of agreement could include elements of the NEA and SCA; and

- the commercial and physical implications for the NTS from having additional entry points. A few examples of the potential impact were provided, which among other things, included the likely treatment of unexpectedly high NTS shrinkage losses arising from low calorific value GDN entry and the appropriate level of market access charges for being able to access the NBP. From a physical perspective, the impact of GDN entry flows on NTS offtake patterns was also considered. Any such issues and the apportioning of any costs incurred would need to be identified by the bilateral contract.

### **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?**

#### **Ofgem's initial thoughts**

1.19. Ofgem considered that it would be preferable for the three existing GDN entry points that are currently deemed to be NTS connected points to migrate to the same contractual arrangements as new GDN entry points in due course. In taking this view, Ofgem was mindful of the importance of preserving existing entry capacity rights at these points.

#### **Respondents' views**

1.20. Six of the seven respondents who provided comments to this question saw no reason why the three existing GDN entry points could not eventually migrate to the new arrangements. In the interests of non-discrimination and transparency, it was deemed appropriate that all GDN entry points should face a consistent set of arrangements. No specific problems were cited with migration, with one respondent noting that it would largely be an administrative exercise, while another considered that the prospect of no longer paying NTS charges would encourage these points to migrate to the new regime.

1.21. The contrary view was taken by one respondent, who believed that migration could potentially pose significant change to pricing and operational regimes, to the extent that a GDN entry point could be made uneconomic. On this basis, they opposed an immediate migration to the new arrangements.

## **How should a timely transition to the new arrangements be facilitated while preserving existing entry capacity rights?**

### **Ofgem's initial thoughts**

1.22. Ofgem invited comments as to how and over what time frame the transition of the existing entry points should be facilitated.

### **Respondents' views**

1.23. Respondents felt less strongly on how best migration should be achieved with only five parties providing comment. Of these, two respondents expressed the view that such discussions should be deferred until the details of the new arrangements were better known. The remaining respondents saw no problem with an October 2007 migration date, assuming that the existing entry points did not want to remain deemed NTS points. In the event that they did, one respondent stated that a decision would need to be made between the preservation of existing rights and having a consistent arrangements across all GDN entry points.

## **Should the size of a GDN entry point be a factor in determining the suitability of the contractual approach?**

### **Ofgem's initial thoughts**

1.24. Ofgem did not provide an initial view on this issue.

### **Respondents' views**

1.25. The two respondents that provided comment agreed that the same approach should be adopted for all GDN entry points, irrespective of size. The size of the entry point would be one of the specific features, amongst others that would need to be considered when agreeing the terms of the contract. Applying differing approaches based on size was deemed to be discriminatory with the potential to create distortions in GDN investment.

## 2. Ofgem's views

### Chapter Summary

This chapter outlines Ofgem's views to the issues raised by respondents in the previous chapter and sets out its final proposals for the long term commercial and regulatory framework for GDN entry.

### Contractual approach

#### Ofgem's views

2.1. Echoing the opinions of the majority of respondents, Ofgem maintains the view that the contractual approach would provide the most appropriate long term commercial and regulatory arrangements for GDN entry points. It offers a flexible solution, in which the specific requirements of each entry point can be considered on a case by case basis. In addition, Ofgem considers the approach to be appropriate given the small number of existing entry points and volume of gas flows, which is not expected to grow significantly in the future. However, should the growth in entry points exceed current expectations, Ofgem may reconsider whether the new arrangements continue to remain suitable.

#### Conclusions

2.2. For the reasons given above, Ofgem concludes that the long term commercial and regulatory framework governing entry points should be based on a contractual approach between new GDN entry points and the relevant GDN. The contractual approach will be applicable to all entry points, irrespective of size. The two parties involved will be expected to enter into negotiations to structure a contract that best reflects the specific characteristics of each entry point. However, GDNs will be able to apply for consent from Ofgem not to enter into an agreement on application from an GDN entry point. Such consent is unlikely to be granted except under exceptional circumstances, for example, in the event that a GDN received a large number of applications for GDN entry arrangements at a similar time, making it difficult for the GDN to give full consideration to each application within the required timescales. Even under these circumstances it is likely that Ofgem would only consent to a delay in offering terms for GDN entry rather than a refusal.

2.3. The new framework is due to take effect on 1 October 2007, although GDNs would be expected to offer terms to new GDN entry points in advance of this date so that a new GDN entry point should be able to enter gas under the new arrangements from 1 October 2007. To help facilitate this Ofgem will seek to make the licence modification by April 2007 pending the agreement of the GDNs.

## **Is a modification of the GDN's Gas Transporters' licence the best way for Ofgem to implement a contractual approach for new commercial and regulatory arrangements for GDN entry points?**

### **Ofgem's views**

2.4. As indicated in its initial proposals, and consistent with the views of the majority of respondents, Ofgem considers that the implementation of the contractual approach would be best achieved through a modification to the GDN's GT licence.

2.5. In reaching this view, Ofgem considers that having clear regulatory obligations in place will minimise the potential risk of parties not being able to agree on the arrangements, which is a potential weakness attached to the flexible nature of the contractual approach.

2.6. In the event that there is a disagreement, Ofgem would want the power to determine the entry arrangements if the matter was referred to us by a GDN entry point. This rules out the UNC, as Ofgem plays no role in determining disputes that arise out of it. The existing dispute resolution mechanisms contained in the Gas Act 1986 and the EU Directive 2003/55/EC do not give Ofgem the requisite powers to resolve such disputes. The current determination powers under the Gas Act apply to disputes between a gas transporter and an existing or potential customer of a gas supplier, or between a gas supplier and an existing or potential customer of a gas supplier. Therefore, the determination powers could not be applied to disputes between a GDN and GDN entry point, where a supplier may not be involved.

2.7. Looking at the EU Directive, we were concerned that the scope of the issues (non-discrimination, competition, efficient functioning of the market, charging methodologies and proportionality with respect to charging methodologies) that could be referred to Ofgem under the Directive may not be sufficiently wide enough to cover all the potential disputes that may arise between the GDN and the GDN entry point. We consider that the most appropriate vehicle for empowering Ofgem should be via the licence condition. While Ofgem will stop short of listing the issues on which we would determine, we would not expect to settle any points of disagreement that are not of a substantive nature. The GDN would be required to offer the GDN entry point arrangements in accordance with the outcome of Ofgem's determination.

2.8. The new licence condition would contain the key principles that each GDN should comply with when entering into GDN entry arrangements. This would include the principle of offering arrangements that are non-discriminatory between different GDN entry points. Although some respondents did not consider a licence modification would be necessary, Ofgem does not believe that the requirement for a GDN to act in a non-discriminatory manner with respect to GDN entry rights is sufficiently covered by the existing licence.

2.9. Some parties requested that GDNs should also be able to seek a determination from Ofgem. We consider that this would be appropriate. However, where a new entry agreement is being negotiated we would expect that a GDN would need to satisfy itself that its offer terms meets its licence obligations and is reasonable before seeking a determination from us. Where either a GDN entry point or GDN disputes the variation of terms with respect to an existing agreement, either party would also be able to seek a determination.

2.10. Some respondents considered that the issues to be covered in the licence condition, as set out by Ofgem in its initial thoughts document, was not far reaching enough, and that it should be extended to incorporate some of the other issues that Ofgem considered would need to be agreed as part of the contractual arrangement. In light of respondents' views, Ofgem has decided to add one further obligation to the licence condition. This covers the requirement for the GDN to reveal and offer to potential new GDN entry points the maximum available entry capacity without the need for system reinforcement.

## **Conclusions**

2.11. The new arrangements will be implemented through a modification to the GDN's Gas Transporters' licence. The licence will contain key principles that the GDN will be required to comply with when entering into GDN entry arrangements, as well as giving Ofgem the ability to determine substantive points if the parties cannot agree on the arrangements. The licence modification will:

- require GDNs to engage in negotiations on GDN entry arrangements upon application from a potential GDN entry point;
- require GDNs to offer terms on a non-discriminatory basis;
- require GDNs to offer the GDN entry point the maximum level of available entry capacity, although the GDN entry point could request and accept less entry capacity;
- require GDNs to publish the main terms and conditions they agree with GDN entry points, subject to respecting the commercial confidentiality of the GDN entry point;
- enable a GDN entry point or GDN to request Ofgem to determine entry arrangements when a new entry agreement cannot be reached and when a dispute arises over a variation of the terms of an existing entry agreement; and
- require GDNs to offer entry arrangements in accordance with any determination made by Ofgem.

2.12. A more detailed account of the main provisions of the proposed new licence condition governing new entry arrangements is given in the next chapter.

## **What are the views of interested parties about the key issues relevant to GDN entry arrangements?**

### **Ofgem's views and conclusions**

2.13. As we proposed in the consultation, there are a number of issues that a GDN and GDN entry point would need to consider as part of the contractual agreement.

#### *Maximum available entry capacity*

2.14. The majority of respondents agreed that the GDNs should be required to reveal and offer to potential new GDN entry points the maximum level of entry capacity without the need to invest in the network. Ofgem agrees with this view and we note that while the GDN should offer the maximum capacity available, the GDN entry point should be able to ask for and accept less capacity if that better meets its requirements. This requirement would not place any obligation on the GDNs to provide the stated maximum capacity on any day if it is unable to do so due to constraints on its network.

2.15. Where a GDN entry point's capacity requirements exceed the network's capability, respondents agreed that any reinforcement work to provide the additional capacity should align with existing customer driven reinforcement for offtakes. We would expect the GDN to determine a customer's contribution, if any, towards reinforcement of the network by applying the Economic Test. In addition, if the entry point was of a sufficient load size, the GDN should also have the option to establish an ARCA in order to guarantee a certain amount of capacity charges.

2.16. If firm capacity is accepted by the GDN entry point, then some form of compensation payment agreed at the time the contract was drawn up could be paid by the GDN in the event of having to interrupt the site. This proposal follows respondents' comments that the application of buy back rights would be inappropriate for GDN entry points.

#### *Apportioning available entry capacity*

2.17. Ofgem considers that the role of apportioning entry capacity to shippers should be decided by the GDN and GDN entry point. If the owner/ operator of the GDN entry point wants to delegate responsibility to the GDN then it would be appropriate for the GDN to recover any reasonable costs incurred for allocating capacity rights. If on the other hand, responsibility for capacity allocation resides with the GDN entry point then it should be required to submit adequate information to the GDN regarding the capacity allocated to shippers.

*Transportation charging arrangements*

2.18. As charging arrangements with respect to GDN entry are not currently in the GDN's transportation charging methodology, Ofgem set out its initial views in the initial thoughts document on what would be the most appropriate form of transportation charges that the GDN could levy. Subsequently, GDNs have indicated that they might not levy any transportation charges on GDN entry points for entering gas into their systems, given that shippers are not currently charged for entering gas into the GDNs from the NTS. If the GDNs did propose to levy any charges they would need to develop, consult on and seek approval for levying charges under their transportation charging methodology. Ofgem would expect the GDNs to work together to develop a broadly consistent methodology.

2.19. In line with the majority of respondents' views and our initial thoughts, Ofgem considers that the existing licence provisions under SSCA5<sup>1</sup> are sufficiently robust to ensure that GDN entry charges are cost reflective and non-discriminatory. Therefore, Ofgem does not intend to include a principle on transportation arrangements in the new licence condition.

*Revenue recovery*

2.20. In its previous document, Ofgem discussed three options for the treatment of revenue that would be derived from transportation and reinforcement charges. Respondents generally supported treating revenue in a manner consistent with GDN exit points. Ofgem therefore considers that the hybrid approach would be the most suitable option. Under this approach, transportation revenue obtained from entering gas into the distribution network would be included in the GDN's price control, while connection revenue would be treated as an excluded service. Any contribution received towards the costs of reinforcement would also be treated as excluded revenue. At the next price control that part of the reinforced asset not paid for by the new GDN entry point would be included in the RAV.

*Operational issues*

2.21. It is expected that the contractual arrangements will need to cover the operational aspects of the entry point. In line with our thoughts in the previous document, Ofgem considers that the existing NEA and SCA, which governs the entry and exit arrangements for NTS sites would form a suitable starting point for discussions between the GDN and new GDN entry points, while recognising there will be some degree of negotiation to reflect the operational issues specific to each entry point. The GDN's management of its operational and technical responsibilities also extend to its interaction with the NTS, as governed by the Offtake Agreement Document (OAD). Therefore, the GDN will need to consider the impact on its NTS requirements from having an entry point connecting to its network, for example, when booking NTS offtake capacity.

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<sup>1</sup> SSCA5 - Obligations as regard charging methodology

*Access to the wholesale market at the NBP*

2.22. To make the entry point commercially attractive, potential GDN entry points have expressed a preference that shippers wanting to enter gas into the distribution network should be able to trade it at the NBP, even though these flows will not actually pass through the NTS. NBP access will make available to shippers the commercial benefits of participating in the wholesale gas market. It also avoids potential distortions of an entry point connecting to the NTS in order to gain NBP access even though a connection to the distribution network would have been a more economic and practical option.

2.23. We propose that shippers entering gas via the distribution network should be able to trade gas at the NBP. This is currently facilitated by the UNC, but a modification to the UNC may be required to continue to facilitate this under the contractual approach.

2.24. Although some respondents wanted this requirement set out as a principle in the licence condition, we do not consider it necessary as we believe it would be better dealt with through the existing mechanism, the UNC.

**Are there any further key issues not discussed in this document that should be considered?****Ofgem's views**

2.25. Respondents raised a number of issues that were not covered by the consultation. Ofgem's views on the main issues are given below.

2.26. Ofgem agrees with the request made by one respondent that the opportunity to revisit the new arrangements should be possible in the event that the number of entry points exceeds current expectations. Ofgem considers this to be reasonable given that the arrangements being proposed are largely based on the assumption that the growth in entry points is likely to be small. As such, any significant growth in entry points may merit a review of whether the arrangements continue to remain appropriate.

2.27. The commercial and physical implications for the NTS from having additional entry points connecting to the distribution network were raised by some respondents. While Ofgem recognises that there could be an impact for the NTS if a significant number of entry points did connect to the GDN, Ofgem believes that only a small number are expected to do so. As such, the flows of gas entering the network should not adversely impact the NTS. As we have already stated however, should the number of entry points exceed current expectations we would consider it appropriate to assess whether the contractual arrangements remain suitable.

## Conclusions

2.28. In light of respondents' views, Ofgem proposes to reconsider the appropriateness of the contractual arrangements if the number of entry points that connect to the distribution network is found to be higher than current expectations. As part of any review, we would consider the impact on the NTS, from a commercial and physical perspective of the higher than expected flow of gas entering the distribution network.

### **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?**

#### **Ofgem's views**

2.29. Ofgem reiterates its recommendation in the consultation document that existing GDN entry points should migrate to the same arrangements as new GDN entry points in due course. In line with respondents' views, Ofgem considers it appropriate that a consistent set of arrangements is applied to all entry points connected to the distribution network.

## Conclusions

2.30. Ofgem proposes that the existing GDN entry points at Hatfield Moor, Wytch Farm and the Isle of Grain should migrate to the new arrangements. Ofgem however, would prefer that these sites moved to the new arrangements on a voluntary rather than a compulsory basis. Therefore, Ofgem will work with these sites to facilitate their transition. Until this takes place, the sites will continue to be subject to the NTS entry arrangements. If the sites have not migrated to the new arrangements by the end of the next transmission price control, Ofgem will consider whether migration at that point should be mandated.

2.31. Since the consultation was published, interim arrangements were implemented in October 2006 to allow Ineos Chlor to start commercial operations of its storage site at Holford. The interim arrangements are time limited, and are due to be replaced by the new arrangements on 1 October 2007.

### **How should a timely transition to the new arrangements be facilitated while preserving existing entry capacity rights?**

#### **Ofgem's views**

2.32. Given that neither Hatfield Moor nor Wytch Farm have acquired long term entry rights, Ofgem would see no reason as to why these sites could not migrate to the new arrangements as soon as they take effect on 1 October 2007. In contrast,

the purchase of long term entry rights at the September 2006 auction by shippers at the Isle of Grain would make transition more difficult to achieve as the benefits expected from the rights that have been purchased would need to be considered.

### **Conclusions**

2.33. As stated above, although transition is expected to be done voluntarily, both Hatfield Moor and Wytch Farm could migrate to the new arrangements on 1 October 2007 in the absence of long term entry rights. However, careful consideration would need to be given to how and over what timeframe migration took place while preserving existing long term entry rights at the Isle of Grain. Ofgem intends to take a final view on this following further discussion with relevant parties at the Isle of Grain.

### 3. Proposed new GDN licence condition for GDN entry rights

#### Chapter Summary

This chapter explains Ofgem's proposals for a new standard special licence condition in the GDNs Gas Transporters' licence setting out the GDNs obligations to offer terms to potential new entry points wanting to connect to the distribution network.

#### Introduction

3.1. This chapter explains the proposed contents of the new licence condition and why Ofgem is proposing the particular terms of the condition. In order to introduce the new licence condition for all GDNs, a Direction under Standard Special Condition D2 of the Gas Transporters' licence proposing to modify the GDN's Gas Transporters' licence will be published in early 2007.

#### The main provisions of the proposed licence condition

##### Obligation to offer terms to potential new entry points

3.2. The overarching obligation that the licence condition proposes to introduce is a requirement for GDNs to offer on request terms to potential new entry points to their network, unless agreed by the Authority. The terms should be consistent with the GDNs' statutory obligations and the provisions of the proposed new licence condition. The new condition defines a potential new GDN entry point in a manner consistent with the definition of NTS entry points. The condition proposes a number of subsidiary obligations to this overarching obligation.

3.3. One such obligation specifies that the terms set out by the licensee should require the GDN entry point to pay for any reasonable costs incurred in reinforcing the network for entry purposes only. Where an entry point is also able to offtake gas from the GDN, the reinforcement and connection costs would be consistent with the relevant provisions for offtake, and therefore reference to this will be excluded from the new licence condition.

##### Requirement for terms to be non-discriminatory

3.4. As discussed in the consultation, Ofgem is proposing that the GDNs be required to offer terms that are non-discriminatory as between different GDN entry points. Ofgem considers that an important benefit of the proposed contractual approach for new GDN entry points is the flexibility for GDN entry points to seek arrangements that best meet their requirements given network capabilities. However, it is important that where new entry points have comparable requirements and network capabilities are similar, the GDN is prepared to offer equivalent terms to each entry

point. This does not stop the nature of the terms being offered evolving over time as new GDN entry points make different requests and new information about the operation of existing terms becomes available.

3.5. Some respondents to Ofgem's consultation suggested that there might be a set of core standard terms similar to the SCA for NTS connected storage sites. Ofgem has no objection to the creation of such a set of standard core terms, providing that GDNs are prepared to consider requests to vary some of these terms where they are not compatible with a new GDN entry point's intended business model.

3.6. To help ensure that the terms offered by GDNs are non-discriminatory, Ofgem is proposing that the GDNs should be required to publish a summary of the key terms of all agreements it reaches with new entry points. This recognises that publishing the full terms of each agreement might in some cases prejudice the commercial position of the new GDN entry point.

#### **Requirement to offer the maximum available entry capacity**

3.7. A number of respondents to the consultation wanted the GDNs to have an obligation to reveal and offer to potential new GDN entry points the maximum available entry capacity without the need for system reinforcement. Ofgem agrees that it is important that the potential new GDN entry point is told by the GDN the maximum available capacity, and is able to obtain that capacity if it wants it. Ofgem recognises however, that it may not always be possible for the GDN to provide the maximum available capacity due to constraints on its network. As such, the requirement to offer the maximum capacity does not place an obligation on the GDN to deliver this capacity if it is unable to.

3.8. If a new GDN entry point wants additional capacity that would require reinforcement of the GDN's network it would be assessed by the GDN in a similar way to new connections or increases in capacity at existing connections, to determine the appropriate contribution from the new GDN entry point to the network reinforcement.

#### **A right for potential new entry points to seek a determination from Ofgem**

3.9. If a dispute arises between the GDN entry point and GDN regarding the offer terms for a new entry agreement, either party would be able to seek a determination from Ofgem. However, before doing this both parties would need to satisfy themselves on whether the terms offered were consistent with the GDN's obligations under the proposed licence condition. Further, Ofgem would expect both parties to have made reasonable attempts to negotiate changes to the terms offered by the GDN to better meet its needs, and to have considered the terms offered by the GDN against any precedents established by previous Ofgem decisions. Should the matter be referred to us, the GDN would then be required to implement the terms of the determination. Although Ofgem would not seek to mediate between the two parties prior to a request for a determination, it would be prepared to meet with both parties to understand their respective positions.

3.10. If either the GDN or the GDN entry point proposed to vary the terms of an existing entry agreement such that it gave rise to a dispute, then either party would be able to seek a determination from Ofgem.

3.11. As set out in the consultation, Ofgem might refuse to make a determination if it considers the matters for determination to be minor in nature. If Ofgem decides to make a determination it will seek the views of both parties and publish the conclusions of its determination.

### **Date of introduction and transition for existing GDN entry points**

3.12. The new arrangements are due to take effect from 1 October 2007. However, subject to considering responses to this consultation and the formal consultation on the licence modification, Ofgem would expect to make the licence modification in the first quarter of 2007. If this is the case, Ofgem would expect the GDNs to commence negotiations with potential new GDN entry points from the time at which the licence modification is made, so that entry arrangements could be in place from 1 October 2007.

3.13. As noted in the consultation, there are four existing GDN entry points, three (Hatfield Moor, Isle of Grain and Wytch Farm) of which are covered by the current NTS entry arrangements, and one at Holford, which is subject to interim arrangements that will expire on 30 September 2007. Ofgem proposes that the existing GDN entry points at Hatfield Moor, Wytch Farm and the Isle of Grain should migrate to the new arrangements. However, Ofgem would prefer that these sites moved to the new arrangements on a voluntary rather than a compulsory basis. Therefore, we will work with these sites to facilitate their transition and until this takes place, the sites will continue to be subject to the NTS entry arrangements.

## 4. Next steps

### Timetable

4.1. The proposed timetable for the development and implementation of the long term commercial and regulatory arrangements is set out below:

- 10 February 2007 - deadline for receiving responses to the draft of the proposed licence condition
- Late February 2007 - Publication of the consultation on the Direction pursuant to Standard Special Condition D2 proposing to introduce a new standard special licence condition;
- 1 April 2007 - Subject to the outcome of the consultation, the Authority will modify the GDN's licence to introduce the new licence condition; and
- 1 October 2007 - New commercial and regulatory arrangements for entry points will take effect for all GDN entry points.

## Appendices

### Index

<b>Appendix</b>	<b>Name of Appendix</b>
1	Consultation questions
2	Draft licence condition
3	Authority's Powers and Duties
4	Glossary

## Appendix 1 - Consultation Questions

1.1. In the July 2006 consultation document on new entry arrangements for connecting to the gas distribution network, Ofgem sought the views of respondents to a number of issues as set out below.

### → CHAPTER: Three

Question 1: Is a modification of the GDN's gas transporters' licence the best way for Ofgem to implement a contractual approach for new commercial and regulatory arrangements for GDN entry points?

Question 2: What are views of interested parties about the key issues relevant to GDN entry arrangements?

Question 3: Are there any further key issues not discussed in this document that should be considered.

### → CHAPTER: Four

Question 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?

Question 2: How should a timely transition to the new arrangements be facilitated while preserving existing entry capacity rights?

## List of respondees to the July 2006 consultation document

List	Name
1	BG Trading
2	EDF Energy
3	EDF Trading
4	Energywatch
5	Ineos Chlor
6	National Grid Distribution
7	National Grid National Transmission System
8	SBGI Gas Storage Operators Group

9	Scotia Gas Networks
10	Star Energy
11	Wales and West Utilities

1.2. All the responses received by Ofgem were not marked as confidential and have been published on Ofgem's website [www.ofgem.gov.uk](http://www.ofgem.gov.uk). Copies of non-confidential responses are also available from Ofgem's library. A summary of responses is given in chapter 1 of this document.

## Appendix 2 - Draft licence condition

1.1. This appendix includes a draft of the proposed standard special licence condition that would be required to implement the new entry arrangements. We are informally consulting on this and we would welcome your comments by 10 February 2007.

### **Standard special condition D12. Requirement to offer terms for the provision of gas entry points**

#### **Purpose of licence condition**

1. The purpose of this condition is to set out the obligations of the licensee from [from 1 April 2007] relating to entering into gas entry agreements in respect of gas entry points to the pipe-line system to which this licence relates.

#### **Requirement to offer terms for gas entry points**

2. The licensee shall (subject to paragraph [5]) offer to enter into a gas entry agreement (unless the Authority otherwise consents) on receiving an application on or after [1 April 2007], made by any person (the "applicant") of an application containing all such information as the licensee may reasonably require for formulating the terms of the offer.

3. In making an offer pursuant to paragraph 2 of this condition, the licensee shall set out the terms on which the licensee shall permit gas to be introduced in to the pipe-line system to which this licence relates, including:

- a. the date (not being earlier than 1 October 2007) when the license shall allow gas to be introduced into the pipe-line system to which this licence relates by means of the gas entry point in respect of which the application was made (time being of the essence, unless otherwise agreed by the person making the application under paragraph 2);
- b. terms that offer the maximum available capacity on the transportation system at the time of the offer, unless the applicant person requests a lesser amount of capacity than the maximum available;
- c. terms that require the applicant person to pay the licensee's reasonable costs incurred through making any necessary reinforcement to the pipe-line system to which this licence relates or carrying out any other activities which are necessary to enable the gas entry point be made available to the applicant;
- d. terms that allow the licensee and the applicant person to refer any dispute arising over the variation of the terms of the gas entry agreement to the Authority to be settled pursuant to paragraph 8 of this condition; and
- e. such other detailed terms in respect of each gas entry point as are or may be appropriate for the purposes of the gas entry agreement.

4. The licensee shall offer terms for agreements in accordance with paragraph 2 as soon as reasonably practicable and (except where the Authority consents to a longer period) in any event not more than [6 months] after receipt by the licensee from any person of an application containing all such information as the licensee may reasonably require for the purpose of formulating the terms of the offer.

5. The licensee shall not be obliged pursuant to this condition to offer to enter into any agreement if to do so would be likely to involve the licensee being:

- a. in breach of its duties under section 9 of the Act;
- b. in breach either of any regulations made under section 18 of the Act or of any other enactment relating to safety or standards applicable in respect of its transportation business;
- c. in breach of any Network Code [Uniform Network Code]; and
- d. in breach of the conditions of this licence or any other licence granted or treated as granted under Section 7 of the Act and held by the licensee.

#### **Non-discrimination**

6. In carrying out the provision gas entry points the licensee shall not unduly discriminate between any persons or class or classes of persons.

#### **Determination of disputes**

7. If, after a period which appears to the Authority to be reasonable for the purpose, the licensee has failed to enter into a gas entry agreement with any person entitled or claiming to be entitled thereto under this condition, the Authority may on application of such person or the licensee, settle any terms of the agreement in dispute between the licensee and that person in such manner as appears to the Authority to be reasonable.

8. If either the licensee or any other party to such agreement proposes to vary the contractual terms of any agreement for gas entry points entered into pursuant to this condition, in any manner provided for under such agreement, the Authority may, at the request of either the licensee or other party, settle any dispute relating to such variation in such manner as appears to the Authority to be reasonable.

#### **Publication of principle terms**

9. The licensee shall publish as soon as reasonably practicable but no later than one month from the date on which it enters into a gas entry agreement the principle terms of that agreement, while having regard to the commercial sensitivity of the other party.

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**Definitions**

10. In this condition:

<b>“gas entry points”</b>	means a point at which gas may be introduced by a third party into the pipe-line system to which this licence relates, but shall not include any point at which such pipe-line system is connected to the pipe-line system of the NTS operator.
<b>“gas entry agreement”</b>	means an agreement made on or after 1 April 2006 between the licensee and another person for connection to the pipe-line system to which this licence relates at a gas entry point for the purpose of introducing gas into that pipe-line system and/or the delivery of gas onto that pipe-line system.
<b>“maximum available capacity”</b>	means the quantity which the licensee determines to be the maximum quantity which it is feasible to make available for entry into the pipeline system to which this licence relates, based on the licensee's 1 in 20 planning obligations.

## Appendix 3 – The Authority's Powers and Duties

1.1. Ofgem is the Office of Gas and Electricity Markets which supports the Gas and Electricity Markets Authority ("the Authority"), the regulator of the gas and electricity industries in Great Britain. This Appendix summarises the primary powers and duties of the Authority. It is not comprehensive and is not a substitute to reference to the relevant legal instruments (including, but not limited to, those referred to below).

1.2. The Authority's powers and duties are largely provided for in statute, principally the Gas Act 1986, the Electricity Act 1989, the Utilities Act 2000, the Competition Act 1998, the Enterprise Act 2002 and the Energy Act 2004, as well as arising from directly effective European Community legislation. References to the Gas Act and the Electricity Act in this Appendix are to Part 1 of each of those Acts.<sup>2</sup>

1.3. Duties and functions relating to gas are set out in the Gas Act and those relating to electricity are set out in the Electricity Act. This Appendix must be read accordingly<sup>3</sup>.

1.4. The Authority's principal objective when carrying out certain of its functions under each of the Gas Act and the Electricity Act is to protect the interests of consumers, present and future, wherever appropriate by promoting effective competition between persons engaged in, or in commercial activities connected with, the shipping, transportation or supply of gas conveyed through pipes, and the generation, transmission, distribution or supply of electricity or the provision or use of electricity interconnectors.

1.5. The Authority must when carrying out those functions have regard to:

- The need to secure that, so far as it is economical to meet them, all reasonable demands in Great Britain for gas conveyed through pipes are met;
- The need to secure that all reasonable demands for electricity are met;
- The need to secure that licence holders are able to finance the activities which are the subject of obligations on them<sup>4</sup>; and
- The interests of individuals who are disabled or chronically sick, of pensionable age, with low incomes, or residing in rural areas.<sup>5</sup>

1.6. Subject to the above, the Authority is required to carry out the functions referred to in the manner which it considers is best calculated to:

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<sup>2</sup> entitled "Gas Supply" and "Electricity Supply" respectively.

<sup>3</sup> However, in exercising a function under the Electricity Act the Authority may have regard to the interests of consumers in relation to gas conveyed through pipes and vice versa in the case of it exercising a function under the Gas Act.

<sup>4</sup> under the Gas Act and the Utilities Act, in the case of Gas Act functions, or the Electricity Act, the Utilities Act and certain parts of the Energy Act in the case of Electricity Act functions.

<sup>5</sup> The Authority may have regard to other descriptions of consumers.

- Promote efficiency and economy on the part of those licensed<sup>6</sup> under the relevant Act and the efficient use of gas conveyed through pipes and electricity conveyed by distribution systems or transmission systems;
- Protect the public from dangers arising from the conveyance of gas through pipes or the use of gas conveyed through pipes and from the generation, transmission, distribution or supply of electricity;
- Contribute to the achievement of sustainable development; and
- Secure a diverse and viable long-term energy supply.

1.7. In carrying out the functions referred to, the Authority must also have regard, to:

- The effect on the environment of activities connected with the conveyance of gas through pipes or with the generation, transmission, distribution or supply of electricity;
- The principles under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed and any other principles that appear to it to represent the best regulatory practice; and
- Certain statutory guidance on social and environmental matters issued by the Secretary of State.

1.8. The Authority has powers under the Competition Act to investigate suspected anti-competitive activity and take action for breaches of the prohibitions in the legislation in respect of the gas and electricity sectors in Great Britain and is a designated National Competition Authority under the EC Modernisation Regulation<sup>7</sup> and therefore part of the European Competition Network. The Authority also has concurrent powers with the Office of Fair Trading in respect of market investigation references to the Competition Commission.

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<sup>6</sup> or persons authorised by exemptions to carry on any activity.

<sup>7</sup> Council Regulation (EC) 1/2003

## Appendix 4 - Glossary

### A

#### Advanced Reservation of Capacity Agreements (ARCA)

The connecting party effectively guarantees to pay the relevant transmission charges when the investment is completed and NGG NTS guarantees to compensate the requesting party for any non-delivery of the capacity after a specified date. GDNs or direct connects that sign an ARCA will also pay some form of penalty payment to the NTS should they amend their capacity request at a later date to a lower volume of capacity.

### C

#### Capacity charges

These charges account for 50 per cent of the revenue recovered by GDNs from distribution use of system charges. Capacity charges are applied to the peak-day demand (in pence per peak day kWh per day).

#### Commodity charges

These charges account for 50 per cent of the revenue recovered by GDNs from distribution use of system charges. Commodity charges are applied to the annual demand (in pence per kWh).

### D

#### Distribution Use of System Charges

Distribution use of system charges are levied by GDNs to gas shippers for the use of the distribution system to transport gas to the end user. They comprise capacity and commodity charges. Approximately 50 percent of the revenue recovered from use of system charges comes from capacity and 50 percent from commodity charges.

### E

#### Economic Test

The ET is a financial assessment tool which was introduced by NGG in 1998 to identify whether a new load should pay a contribution towards the reinforcement required for its connection. It compares the incremental cost of connecting a customer to the gas distribution network with the expected revenue from distribution charges associated with that customer, using NPV calculations.

**G****Gas Distribution Network (GDN)**

GDNs transport gas from the NTS to final consumers and to connected system exit points. There are currently eight GDNs in Great Britain which comprise twelve LDZs.

**L****Local Distribution Zone (LDZs)**

LDZs are low pressure pipeline systems which deliver gas to final users and Independent Gas Transporters. There are twelve LDZs which take gas from the high pressure system transmission system for onward distribution at lower pressures.

**N****NTS Offtake Capacity**

Built to ensure sufficient pipeline capacity is available to convey gas from the NTS to the GDNs and NTS direct connects at the required rate and quantities.

**National Transmission System (NTS)**

National Grid's high pressure gas transmission system consists of more than 6.400 km of pipe carrying gas at pressures of up to 85 bar (85 times normal atmospheric pressure).

**Network Entry Agreement (NEA)**

The NEA sets out the terms and conditions by which gas is entered in to the distribution network. The requirements for an NEA are set out in Section I of the UNC.

**S****Storage Connection Agreement (SCA)**

The SCA is a combined entry/exit agreement which shares technical and operational information between NGG NTS and the storage operator. There are no existing SCAs for embedded GDN entry points.

**Storage Facility**

Facility used for the storage of natural gas; usually a cavern carved out of natural salt domes or depleted natural gas reservoirs into which natural gas can be reinjected and produced with minimal loss.

**U****Uniform Network Code (UNC)**

As of May 1 2005 the UNC replaced National Grid Gas' Network Code as the contractual framework for the NTS, GDNs and system users.

## Appendix 5 - Feedback Questionnaire

1.1. Ofgem considers that consultation is at the heart of good policy development. We are keen to consider any comments or complaints about the manner in which this consultation has been conducted. In any case we would be keen to get your answers to the following questions:

- Does the report adequately reflect your views? If not, why not?
- Does the report offer a clear explanation as to why not all the views offered had been taken forward?
- Did the report offer a clear explanation and justification for the decision? If not, how could this information have been better presented?
- Do you have any comments about the overall tone and content of the report?
- Was the report easy to read and understand, could it have been better written?
- Please add any further comments?

1.2. Please send your comments to:

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