

Mark Feather
Associate Director, Transmission
Office of Gas and Electricity Markets
9 Millbank
London
SW1P 3GE

Chris Bennett
Transmission Regulation Manager
chris.bennett@uk.ngrid.com
Direct tel +44 (0)1926655949

www.nationalgrid.com

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Dear Mark

NTS gas offtake: Proposals for licence modification drafting

We welcome the opportunity to respond to Ofgem's proposals for licence modification drafting with regards to NTS gas offtake and offer the following comments in response to the consultation. Our response is structured to cover the following areas:

- a) General licence structure;
- b) Policy points; and
- c) Drafting issues.

a) General licence structure

In general, we agree with Ofgem that the proposed reorganisation of the current Special Condition C8B into separate licence conditions covering different incentive areas should make the licence easier to understand. However, we believe that the understanding of the exit part of the drafting (under the proposed Special Condition C8E) would have been further enhanced were the condition to be split into the three separate incentive periods; interim, transitional and enduring, as this would have made clear the incentive terms which apply in which period.

b) Policy points

Revenue driver

We do not agree with the proposals for the operation of the revenue driver for the South West Quadrant. The revenue driver term for specific projects (ExCIIR^{projspec}) operates in such a way as to remunerate the investment irrespective of the amount of exit capacity actually booked, i.e. user commitment is used as a trigger to provide remuneration for the whole project rather than on a GWh/d basis. By contrast, the South West Quadrant revenue driver (ExCIIR^{swquad}) operates based on the amount of capacity actually booked. We therefore believe that there could be circumstances whereby we receive appropriate user commitment for a certain level of incremental capacity, but the revenue driver fails to sufficiently remunerate the efficient investment as the amount of capacity booked would be less than that delivered by the minimum efficient investment. We believe that it therefore does not take into account the lumpiness of investment which will be inevitable given the likely small increments of incremental capacity demanded at exit.

Annuitisation factor

We do not agree with the actual annuitisation factor which has been applied to calculate the annual revenue drivers. We understand that the factor has been calculated in a similar manner to the ones

which currently exist within the licence today which are based on an assumption of 20% of spend incurred in year t-2 and 80% of spend incurred in year t-1 to deliver capacity in year t. Based on this assumption of spend profile, it is appropriate to fund the depreciation which is related to the 20% spend in the year after actual spend prior to delivery of the capacity. However, we believe that this has not been assumed within the calculation of this annuitisation factor and therefore believe that the appropriate figure (using the assumption within the September Updated Proposals of a 6% CoC) would be 0.09986 rather than the 0.09910 quoted.

Further revenue drivers

We also do not believe that the drafting as currently written deals with new loads onto the NTS or increases to offtakes within any other DNs other than within the SWQ. In view of the proposals to reform the DN interruption arrangements from October 2010, we believe that it should be made clear that there will be an intent by Ofgem to bring forward licence modifications to amend the NTS licence to include revenue drivers for these situations were investment upon the NTS to be needed to cater for this.

Revenue driver indexation

We note that the drafting provides for the revenue driver for exit to be inflated for RPI, however, we believe that the operation of the revenue drivers needs to include some form of indexation to take into account the large price rises we have seen with regards to either steel costs or contractor costs and we look forward to discussing with Ofgem an appropriate mechanism to deal with this.

Clearing allocation

We note that the definition of a “clearing allocation” is still contained within Special Condition C8A. We had understood that there was consideration of this obligation being removed on the entry side and therefore wonder if this definition is still needed. We would welcome further debate with Ofgem over this matter.

c) Drafting issues

Further to these issues of policy above, we have certain other comments which relate to the drafting itself:

Special Condition C8A

- Within Special Condition C8A, the terms “NTS obligated incremental exit flat capacity” and “NTS obligated incremental exit flow flexibility” are not inserted in alphabetical order;
- We note that the term “NTS exit capacity constraint management” is used within Special Condition C8E but does not appear to be a defined term within Special Condition C8A. We therefore believe that a definition for this term needs to be added into Special Condition C8A; and
- We understood that the term “Transco plc” was being replaced by “National Grid Gas plc” where appropriate. There will need to be a definition for this added into Special Condition C8A and we suggest the following “National Grid Gas plc means the company (registered in England and Wales under company registration number 2006000) which was previously known as Transco plc”.

Special Condition C8B

- We believe that within paragraph 3 (b)(B) the drafting could be shortened by replacing “In respect of any formula year commencing on 1 April 2008 or on 1 April in any subsequent year:” by “Otherwise”; and

- We have repeatedly asked Ofgem to consider the introduction of a deadband around the operation of the “ I_t ” term within paragraph 3(b), as exists within the current NGET licence Special Condition AA5A (I_t only has penal interest rate if actual revenue is more than 2.75% above allowed). We believe that this would be a more appropriate manner to deal with any over-recovery.

Special Condition C8C

- Within paragraph 2(a), the term $SOExRF_t$ refers to “sales of exit capacity”, but this is not a defined term. We believe the paragraph should refer to “sales of NTS exit capacity”;
- Within paragraph 3(a), we believe the word “any” should be inserted after “means” in the definition of SOR_t ;
- Within paragraph 3(c), we do not believe that it is achievable (by 1 April 2007) to be able to determine the appropriate value for SOK_t as the allowed revenue term $SOMR_t$ will not be known with certainty until the costs for the previous formula year are fully determined (which will be after 1 April 2007), hence the term SOK_t will also be unknown. We believe the drafting will need to reflect this and possibly have some wording indicating that the value will be determined at a later date;
- Within paragraph 3(c), the drafting could be shortened by replacing “In respect of any formula year commencing on 1 April 2008 or on 1 April in any subsequent year:” by “Otherwise”; and
- Within paragraph 5(f), there appears to be a typographical error in that C8F is repeated twice. We believe the first occurrence should refer to Special Condition C8E rather than C8F.

Special Condition C8E

- We believe it is appropriate to consider if the principal restriction is still applicable – i.e. is the 4% over-recovery in 1 yr and 6% in two-years still valid due to the volatility of $SOMR_t$ and SOR_t terms;
- We do not understand why there is yet another definition of RPI inserted within paragraph 1(d). We believe it would be appropriate to standardise (where appropriate) throughout the licence to have one definition for RPI;
- Within the definition of “ $CDEL_{p,t}$ ” in paragraph 1(d)(i), we believe the definition should refer to the date at which capacity is obligated to be delivered from rather than just the term delivered. If this is not the case, we believe the drafting would not reflect Ofgem’s policy that the revenue driver should apply from contractual delivery of capacity not physical delivery;
- We are not sure whether the term “ $DEL_{z,t}$ ” within paragraph 1(d) (ii) should be written to reference “NTS incremental exit shipper capacity” rather than “NTS incremental exit capacity” as this latter term also includes the flow flexibility product;
- We believe that the definition of the nodes within the south west quadrant may need to be re-assessed. We do not understand why Langage and Marchwood are included as these will be funded via the project specific revenue driver. We also have concerns that the drafting is not specific enough to deal with the offtakes where we currently provide both a firm and interruptible service (e.g. Didcot A, Terra Nitrogen (ICI Severnside) or Abson (Seabank Power II)). The revenue driver should apply to any increase in their firm entitlement, whereas the Long-run contracting allowance will deal with the current interruptible part going firm;
- Within paragraph 2(a)(i), we are not sure why the terms “ $TREVExC_t$ ” and “ $TREVBFF_t$ ” are included within the term “ $TOExRF_t$ ”, as they appear to only relate to the enduring period, but the term “ $TOExRF_t$ ” is explicitly set to zero from 1/10/2010 hence does not apply in that period. However, if these are retained, then the definition of “ $TOExRF_t$ ” needs to also reference charges levied on “DN operators” in addition to “gas shippers”; and

- Within paragraph 2(c)(i), we believe that the fixed date of 1 April 2007 is unachievable and believe it should be replaced by “on or before 1 April 2007 or as soon as is reasonably practical thereafter”; and
- We have repeatedly asked Ofgem to consider the introduction of a deadband around the operation of the “ I_t ” term within paragraph 3(c) as exists within the current NGET licence Special Condition AA5A (I_t only has penal interest rate if actual revenue is more than 2.75% above allowed). We believe that this would be a more appropriate manner to deal with any over-recovery.

Special Condition C18

- Within the title and paragraphs 1 and 3, we believe the term “exit capacity” needs to be replaced by “NTS exit capacity”;
- Within paragraphs 1 and 4 we believe that the fixed date of 1 April 2007 is unachievable and believe it should be replaced by “by 1 April 2007 or as soon as is reasonably practical thereafter”.

I hope that you find these comments useful and look forward to working with Ofgem to refine the final licence drafting.

Yours sincerely

Chris Bennett (by email)

Regulatory Frameworks Manager

cc: Tim Tutton