

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

Chris Bennett  
Regulatory Frameworks Manager

Chris.Bennett@uk.ngrid.com  
Direct tel +44 (0)1926 655949

[www.nationalgrid.com](http://www.nationalgrid.com)

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Dear Mark

**Re: Ofgem consultation document “National Grid Gas – Offtake Arrangements Final Impact Assessment on modification proposals”**

We welcome the opportunity to comment on Ofgem’s consultation document “National Grid Gas – Offtake Arrangements Final Impact Assessment on modification proposals”. This response is written on behalf of National Grid Gas plc (“NGG”) in its capacity as the holder of a gas transporter licence in respect of the National Transmission System.

Executive Summary

We note that there are significant uncertainties associated with quantifying both the costs and benefits in respect of the various UNC Modification Proposals. We therefore consider that it is essential for differences in the net benefits between the various Proposals to be understood and justified if used to support the Authority decision making process. We consider that it is clear that the costs of implementing 0116CVV are less for all market participants than the other Proposals (excluding 0116A) on the basis that there are no changes to support implementation and operation of the flexibility capacity arrangements. However it is not clear why the costs of implementing and operating 0116BV and 0116VD would be less than 0116V as they are based on the same processes and principles. We would therefore be concerned if either of these alternate proposals were implemented in preference to 0116V on the basis of the Impact Assessment analysis.

We conclude from the Impact Assessment that, unless there are justifiable qualitative benefits to warrant reform of the current flexibility capacity arrangements, which does not seem the case from the information within the Impact Assessment, that implementation of 0116CVV would be a pragmatic way forward. This would still introduce common flat capacity arrangements across all NTS Exit Points bringing benefits in respect of more efficient network development, promotion of competition and transparency while minimising costs.

We note that the approach proposed under 0116CVV would be supported by publication of daily information in respect of flexibility utilisation, so that the industry could closely monitor the effectiveness of the continuation of the current flexibility capacity arrangements. This would however require system changes to support such data publication which could not be completed until towards the end of 2007. We trust that these issues will be taken into consideration by the Authority in its decision making process.

We provide below specific points on the quantitative and qualitative analysis.

## Quantitative Analysis

In respect of the benefits of reform, we note that Ofgem has sought to quantify the benefits that may arise from the following:

- More efficient NTS investment signals resulting in estimated £42m saving over 10 years based on the avoidance of one large exit project for all Proposals (except 0116A). In principle we agree that more efficient investment signals would result from increased financial commitments by Users. However, we consider that the robustness of Ofgem's assessment depends on whether the change from a 1 year to a 4 year financial commitment and increased notice periods to reduce capacity will actually deliver the stated benefits.
- Non-discrimination of allocation of capacity products allowing full benefits of comparative regulation between DNs to be realised resulting in NPV benefit of £20m. In particular we note that this is driven by concerns that DNs may be allocated a disproportionately low volume of capacity on an unfair basis resulting in it choosing to undertake additional investment in its own network that otherwise would not be undertaken. Although we agree with such principles, NGG has not, in its view, unfairly allocated capacity between DNs or is likely to do so in the foreseeable future. We therefore question whether the current arrangements are not already providing such benefits.
- Reduced incidence of ARCA disputes providing an NPV benefit of £10m. We understand that this is proposed on the basis that there should be less ARCAs under the enduring regime as Users would be able to register long term capacity under the UNC and, where ARCAs are executed with non-UNC parties, that they would be based on same level of required financial commitments framework as applicable for UNC Users. We consider that such proposed benefits would be fully realised if only UNC parties could secure long term capacity i.e. ARCAs were not utilised and developers obtained the support of a shipper to signal incremental capacity requirements via the UNC. Indeed the proposed increase from a 1 year to 4 year financial commitment could result in an increased number of ARCA disputes, particularly considering the recent Marchwood determination by the Authority.

In respect of the costs, we have the following comments:

- We are concerned over the wide range of costs provided by shippers and note that the headline cost-benefit analysis provided in the report summary is a worst case estimate. In particular we note that cost estimates do not seem to have reduced from earlier cost surveys, despite the development by NGG of the use of OPNs to register daily flexibility capacity to avoid use of auctions as much as possible. This OPN process will create additional system and administrative costs for NGG, and hence if there is no reduction in shipper costs, as the primary purpose of the OPN process, then this suggests that such a process would be counter-productive and should be re-considered.
- We are surprised that the costs provided by Gas Transporters and the Agency are fully excluded from the overall cost-benefit analysis. Our understanding from the cost survey was that at least additional administrative costs were to be considered.
- It is difficult to understand from the information included in the Impact Assessment why costs vary so much between the Proposals. Such differences appear to be generated

due to the different proposed treatment of flexibility capacity under the enduring arrangements. In particular, we are concerned that the costs of implementing UNC Modification Proposals 0116BV and 0116VD, while similar in principle to 0116V, are proposed to result in £4-6m less costs. It would be beneficial if there was greater clarity on how such reductions would be realised to allow respondents to comment on such views.

### Qualitative Analysis

We note that Ofgem has sought to identify qualitative factors that may give rise to additional costs and benefits beyond that identified through the quantitative analysis. We broadly agree with the principles of the qualitative analysis, however we note the following:

- in respect of the suggestion under 4.5 that reform of the flexibility capacity arrangements might reduce the need for NGG to take within day gas balancing actions to manage within day flow variations, we note that, to date, our balancing actions have predominantly been driven by end of day requirements, as opposed to within day flow variations.

In addition we note that there is no consideration in respect of:

- the interaction of NTS offtake reform with the potential reform of the LDZ interruption arrangements. In particular, we consider that the DN incentive arrangements are critical to ensure that the full benefits of NTS offtake reform are realised and that there is the right balance between investments across both transmission and distribution network.
- the benefits of better alignment of the GB access regime with the EU Gas Regulations in respect to third party access to support liberalisation of the European gas market.

Please do not hesitate to contact either me or Paul Roberts on 01926 656369 if you wish to discuss our response.

Yours sincerely

Chris Bennett  
**Transmission Regulation Manager**