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Dear Mark,

## **Response to Ofgem Consultation 23/07, National Grid Gas – Offtake Arrangements Final Impact Assessment on modification proposals**

Thank you for the invitation to respond to the Ofgem consultation on the Offtake Arrangements Final Impact Assessment on modification proposals. We have structured our response to include some high level comments on the impact assessment and response to the questions as set out in the document. This response is sent on behalf of National Grid Gas Distribution.

### **High Level Comments**

At the outset we would like to reiterate our support for Exit Reform to the extent that the benefits of the proposals can be demonstrated to outweigh the costs. In terms of the consultation document we welcome the outcome of the impact analysis which suggests that proposal 0116CVV has the largest net benefit. We note however that the qualitative benefits do not add to the economic case and by their nature the quantitative benefits can be uncertain and therefore at risk of being overstated whilst the costs are more tangible. In view of this uncertainty it should be recognized that the cost benefit analysis runs the risk of being eroded.

### **Comments on the process associated with the modification process**

As we have stated previously in response to the consultation on the UNC Modification Proposal 0116 and alternates we do not think that the present UNC modification process was really designed to cope with the fundamental regime change proposed by these proposals. Such regime change inevitably requires lengthy and detailed consultation on the principles of the proposal, the legal drafting and the associated changes to the licence including, in this case, changes to both the NTS licence and the DN's licences in respect of incentive arrangements. In the case of modification proposal 0116 respondents were also asked to state their preference for alternates whilst only having legal text available for one of the proposals, 0116V. This does of course introduce an element of risk into the modification process. It appears to us that whilst the mod process is an effective way of selecting from competing proposals, it does not lend itself to developing an optimal proposal.

Also, many industry participants will need time to deal with any associated contractual arrangements and system developments. In this regard a long lead time for implementation of changes of this magnitude would help.

### **Comments on the quantitative analysis of benefits and costs**

In terms of the benefits we note that the analysis concentrates on the following categories:

- improving investment signals
- reducing the potential for discrimination
- promoting competition

- reducing the likely incidence of disputes

In terms of improving investment signals we would like to make the comment that User Commitment only helps the NTS make efficient decisions if the User is able to make efficient decisions in turn. In this way the DNs incentive targets should be structured such that they make investment decisions in their own networks based on firm price signals from the NTS. Considering discrimination, we reaffirm our view that there should not be discrimination between DN customers and NTS-connectees and in this respect proposal 0116CVV is preferable. In terms of promoting competition we do not believe that the flow flexibility product would promote competition. The reasons for needing the product are different for DNs and NTS-connectees because DNs have transporter obligations to meet the demands of their customers whilst NTS-connectees will have mainly commercial drivers. Finally, an ARCA dispute will relate to the prices or other conditions contained within the ARCA. Hence the key to reducing the cost of the dispute lies in the adoption of a fair and transparent charging methodology, rather than removing the need for ARCAs altogether.

In terms of costs, our comments are somewhat limited because the transporter costs have been discounted and we are not in a position to comment on shipper costs. We would note however that the case for lower shipper costs is made on the basis of the costs of the four lowest cost shippers. In many ways this is a dangerous assumption because the forecasts may be under-estimated. Clearly the case would be more robust using all shipper costs. In terms of a comparison of the alternates it is interesting to note that a large proportion of the costs are driven by the flow flexibility product. This is probably not surprising in view of the complexity associated with the product as described in all of the products apart from 0116A and 0116CVV.

#### **Comments on the qualitative analysis of benefits and costs**

Our comments in this section are limited to the appropriate allocation of risk and simplicity and transparency. The other categories of efficient investment, promotion of competition and preventing undue discrimination are covered in the quantitative analysis section. Our comments on efficient investment also apply to those on security of supply.

In terms of appropriate allocation of risk we would like to reiterate that User commitment would be most beneficial where the User responds in the light of the most appropriate economic signals. Therefore, in order to make the efficient trade off between investment on its network, buying NTS Exit Capacity and buying interruption rights a DN needs firm prices from the NTS at the time of buying capacity. Also, as we have stated previously user commitment is only appropriate to very large consumers whose individual decisions have a significant impact on the gas infrastructure. Most growth results from either the connection of additional smaller loads, or general load growth amongst smaller users. In this respect User commitment is in effect DN commitment.

In terms of transparency and simplicity, notwithstanding that the present arrangements benefit from both of these characteristics, we acknowledge that the prevailing rights model for flat capacity enshrined in Mod 0116 is better than the complexity described under the TANIF model, previously proposed. In terms of flow flexibility we have concerns about the product as described in Mod 0116 particularly with respect to having to purchase flow flexibility for within day changes to demand. We have shared with the industry an initial proposal on the definition of flow flexibility and hope to bring this forward as a firm proposal in the future.

If you wish to discuss any of these comments any further, please do not hesitate to contact me.

Yours sincerely

***By Email***

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