

Modification proposal:	Modification Proposal NTS GCM 04 'Introduction of NTS Exit (Flexibility) Capacity Charges under the Enduring Offtake Arrangements'		
Decision:	The Authority¹ has decided not to veto this proposal²		
Target audience:	NGG and other interested parties		
Date of publication:	07 June 2007	Implementation Date:	To be advised by the Joint Office

Background to the modification proposal

The sale of Gas Distribution Networks (GDNs) in 2005 required the establishment of a new commercial framework at the interface between the National Grid Gas (NGG) National Transmission System (NTS) business and the GDNs. On 5 April 2007 the Authority directed the implementation of UNC Modification Proposal 0116V³ which provided for the introduction of enduring offtake arrangements. UNC116V allows users to signal and register their long-term requirements of NTS offtake capacity with the aim of treating all users on the NTS equally by making available the same offtake capacity products to both GDNs and shippers acting on behalf of Transmission Connected Customers (TCCs).

UNC116V makes two general categories of products available to all NTS users for exit, or offtake, capacity. These are:

- **NTS exit (Flat) capacity** – this gives users the right to offtake a daily quantity of gas at an NTS exit point at an even rate across the Gas Day; and
- **NTS exit (Flexibility) capacity** - is the right to offtake gas in aggregate over a Gas Day at one or more entry points within an NTS Exit Zone (to be defined in ExCR methodology statement) at flow rates which deviate from the even flow rate of NTS exit (Flat) capacity. Actual utilisation of NTS exit (Flexibility) capacity is determined by the cumulative allocated quantity a user has taken off the system between 06:00 and 22:00 minus 2/3 of total end of day allocated quantity.

There are two types of NTS exit (Flexibility) capacity product, these are:

- **Annual NTS exit (Flexibility) capacity** – this is firm flexible capacity for each Gas Day in the Gas Year; and
- **Daily NTS exit (Flexibility) capacity** – this is firm flexible capacity for a Gas Day only.

Annual NTS exit (Flexibility) capacity is acquired through pay-as-bid annual auctions held in July in Gas Year Y for use in Gas Years Y+1 to Y+5. Daily NTS exit (Flexibility) capacity is acquired by users applying for Individual Offtake Profile Notices (IOPNs) or through pay-as-bid daily auctions.

With the introduction of annual and daily auctions to allocate NTS exit (Flexibility) capacity a reserve price is required as the minimum acceptable bid price that NGG will accept in order to allocate the capacity.

¹ The terms 'the Authority', 'Ofgem' and 'we' are used interchangeably in this document. Ofgem is the Office of the Gas and Electricity Markets Authority.

² This document also constitutes notice of the reasons for this decision as required by section 38A of the Gas Act 1986.

³ "Uniform Network Code (UNC): Reform of the NTS offtake arrangements (UNC 0116V, 0116BV, 0116CVV, 0116VD and 0116A)", Ofgem, 5 April 2007

The modification proposal ("the Proposal")

Through modification proposal NTS GCM 04 (Introduction of NTS Exit (Flexibility) Capacity Charges under the Enduring Offtake Arrangements) NGG proposes that a zero reserve price is to be applied for NTS exit (Flexibility) capacity at all NTS exit zones for the annual and daily auctions.

This results in the price of NTS exit (Flexibility) capacity obtained through IOPNs (where daily auctions are not required) also being zero.

NGG proposes that NTS GCM 04 is implemented in order to set NTS TO exit (Flexibility) capacity reserve prices from July 2008 for NTS exit (Flexibility) capacity to be used from 1 October 2011.

Justification of the modification proposal

NGG considers that NTS GCM 04 better achieves the relevant gas transmission transportation charging methodology (the "Charging Methodology") objective that in so far as prices in respect of transportation arrangements are established by auction, either:

- i. no reserve price is applied, or
- ii. that the reserve price is set at a level –
 - I. best calculated to promote efficiency and avoid undue preference in the supply of transportation services, and
 - II. best calculated to promote competition between gas suppliers and between gas shippers

NGG's argument for NTS GCM 04 is that as a zero reserve price is applied then effectively no reserve price is applied and this achieves the relevant objective outlined above.

Furthermore NGG states that the allocation process for NTS exit (Flexible) capacity first ranks users' bids in price order, regardless of their zone, then subject to national, area and zonal limits. NGG argues that this prevents, to an extent, users in zones with fewer users having access to potentially cheaper NTS exit (Flexibility) capacity than users in zones with larger number of users. NGG argues this improves market liquidity and with a zero reserve price ensures an efficient auction process.

NGG also believes that NTS GCM 04 is consistent with EC Regulation 1775/2005 on conditions for access to the natural gas transmission networks as it would not lead to market distortions and would be applied consistently. Additionally, NGG argues that the reserve price of zero reflects costs since NTS exit (Flexibility) capacity is generated as a by-product of NTS exit (Flat) capacity.

Responses to NTS GCM 04

NGG consulted on the proposals in February and March 2007 and received six responses. Five respondents supported NTS GCM 04 with one respondent unable to support it. However, the one respondent which was unable to support NTS GCM 04 did support the principle of charging for NTS Exit (Flexibility) capacity at zero price.

The main view from respondents was to support a zero reserve price for NTS exit (Flexibility) capacity, despite not supporting UNC116V which introduced the NTS exit (Flexibility) capacity product to all users.

One respondent was concerned that the use of auctions to allocate NTS exit capacity and NTS GCM 04 do not meet EC Regulation 1775/2005 as (i) auctions are a complex system which do not facilitate efficient gas trade and competition (ii) they do not provide incentives for investment as no incremental NTS exit (Flexibility) capacity will be released from auctions, and (iii) auctions will distort trade across borders.

The Authority's decision

The Authority has considered the issues raised by the modification proposal and the Final Modification Report (FMR) dated 10 May 2007. The Authority has considered and taken into account the responses⁴ to NGG's consultation. The Authority has concluded that:

- 1. implementation of the modification proposal will better facilitate the achievement of the relevant objectives of the Methodology⁵; and**
- 2. deciding not to veto the proposal is consistent with the Authority's principal objective and statutory duties⁶.**

Reasons for the Authority's decision

Under UNC116V NGG will be required to release 22 mcm of flexibility rights per day. Ofgem considers that it is appropriate for the release of the 22 mcm flexibility rights per day to occur on a zero reserve price basis for the reasons outlined in the discussion of SSC A5(5)(aa) and A5(5)(c) below.

SSC A5(5)(aa) - in so far as prices in respect of transportation arrangements are established by auction, either:

- i. no reserve price is applied, or*
- ii. that the reserve price is set at a level –*
 - I. best calculated to promote efficiency and avoid undue preference in the supply of transportation services, and*
 - II. best calculated to promote competition between gas suppliers and between gas shippers*

As the proposal is to set a reserve price of zero for NTS exit (Flexibility) capacity then Ofgem considers that this relevant objective is achieved since no reserve price is applied.

SSC A5(5)(b) - so far is consistent with sub-paragraph (a), the charging methodology properly takes account of developments in the transportation business

The submission of proposal NTS GCM 04 is in response to the developments taking place regarding enduring offtake arrangements and therefore allows the charging methodology to reflect the decision made by the Authority to approve UNC116V.

⁴ NGG modification proposals, modification reports and representations can be viewed on the NGG website at www.nationalgrid.com

⁵ As set out in Standard Special Condition A5(5) of NGG's Gas Transportation Licence, see: http://epr.ofgem.gov.uk/document_fetch.php?documentid=8783

⁶The Authority's statutory duties are wider than matters which the Panel must take into consideration and are detailed mainly in the Gas Act 1986.

SSC A5(5)(c) – so far is consistent with sub-paragraphs (a) and (b), compliance with the charging methodology facilitates effective competition between gas shippers and between gas suppliers

Ofgem considers that the use of a zero reserve price ensures that all NTS exit (Flexibility) capacity is released to the market which should secure effective competition and enable the market for NTS exit (Flexibility) capacity to clear. Furthermore, a zero reserve price should promote price discovery for NTS exit (Flexibility) capacity.

With regards to the respondent concern that NTS GCM 04 does not meet EC Regulation 1775/2005, Ofgem considers that the implementation of GCM04 is compliant under Article 3 of that Regulation.

On 30 April 2007 E.ON appealed against the Authority's decision on 5 April 2007 that UNC116V be implemented. The outcome of the appeal process is still pending at the time of publication of this letter. Ofgem notes that if the decision to approve UNC116V is successfully appealed and UNC116V is not implemented then there will be no NTS exit (Flexibility) capacity product available to all users. NGG has suggested that under these circumstances it would raise a modification proposal to deal with this.

Decision notice

In accordance with Standard Special Condition A5 of NGG's Gas Transportation Licence, the Authority has decided not to veto modification proposal GCM04: Introduction of NTS Exit (Flexibility) Capacity Charges under the Enduring Offtake Arrangements.



Robert Hull
Director, Transmission

Signed on behalf of the Authority and authorised for that purpose.