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value for all customers*

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23 October 2007

Dear Chris,

Re: Proposal to Release Incremental Obligated Entry Capacity at Isle of Grain

Summary

The Gas and Electricity Markets Authority (the "Authority")¹ has considered the proposal submitted by National Grid Gas NTS (NGG NTS) on 15 October 2007 for additional firm entry capacity at Isle of Grain to be treated as incremental obligated entry capacity (the "Proposal") pursuant to Special Condition C8D(9)(f) of NGG NTS's gas transporter licence (the "Licence"). For the reasons set out in this letter the Authority has decided not to notify NGG NTS to suspend implementation of the Proposal and not to direct NGG NTS not to implement the Proposal pursuant to Special Condition C8D(9)(k)(i) and (ii).

This letter outlines the background to the Proposal and the Authority's reasons for its decision.

Background

On 16 July 2007 the Authority approved NGG NTS's Incremental Entry Capacity Release (IECR) methodology². This methodology is detailed in Special Condition C15 of the Licence and describes the process by which NGG determines whether to make incremental entry capacity available for sale to gas shippers.

Between 17 and 25 September 2007 NGG conducted the Quarterly System Entry Capacity (QSEC) auctions whereby it invited shippers to bid for entry capacity to the NTS at a number of Aggregate System Entry Points (ASEPs).

NGG uses the information from the QSEC auction to allocate entry capacity to shippers and for planning purposes. The IECR methodology is applied to the results of the QSEC auction for the planning purposes of determining whether or not to allocate obligated incremental entry capacity rights to users.

The IECR methodology allows for a Net Present Value (NPV) test to be conducted if at any ASEP a minimum quantity of incremental capacity is demanded i.e. demand exceeds supply. The NPV test assesses whether the revenue from a quantity of incremental entry capacity equals at least 50% of the 'estimated project value' and if it does then NGG

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

² Version 7.0

proposes to the Authority that the quantity of incremental entry capacity be treated as incremental obligated entry capacity as defined in the Licence.

NGG's Proposals

On 15 October 2007 NGG NTS submitted a proposal pursuant to Special Condition C8D(9)(f) of the Licence for additional firm entry capacity at Isle of Grain to be treated as funded incremental obligated entry capacity. This is for the release of 246.24 GWh/day of incremental obligated entry capacity at Isle of Grain from 1 October 2010.

NGG NTS submitted further information to the Authority on 17 and 18 October 2007 for considering the application made by NGG NTS. This information related to how the bid data from the QSEC auction triggered an NPV test at Isle of Grain and the NPV test calculation itself.

Ofgem's view

The information submitted by NGG NTS on 15, 17 and 18 October provided the Authority with sufficient information to determine whether the relevant criteria of the IECR methodology had been met.

Ofgem reviewed the information submitted by NGG NTS and considered that the relevant criteria in the IECR methodology had been met.

For the avoidance of doubt, by not using the powers in the Licence to notify NGG NTS to suspend implementation of the Proposal or direct NGG NTS not to implement the Proposal this does not fetter the discretion of the Authority on other issues leading up to the submission of the Proposal, arising out of the Proposal or required for the successful implementation of the Proposal. This includes but is not limited to Ofgem not approving or disapproving the particular investments that NGG NTS will make in order to offer for sale the incremental obligated entry capacity outlined in the Proposal, as these investments will be assessed at the time of the next Transmission Price Control Review.

The Authority's decision

The Authority has carefully considered the Proposal submitted by NGG NTS pursuant to Special Condition C8D(9)(f) of the Licence. The Authority has decided that NGG NTS should implement the proposal, and in the circumstances the Authority has decided not to: -

- (i) notify NGG NTS that implementation of the proposals should be suspended pursuant to Special Condition C8D(9)(k)(i) of the Licence, or
- (ii) (ii) direct NGG NTS that the proposals should not be implemented pursuant to Special Condition C8D(9)(k)(ii) of the Licence.



Robert Hull
Director, Transmission
Duly authorised on behalf of the Authority