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Dear Bob,

National Grid Transmission response to Transmission Price Control Review – gas entry baseline re-consultation (234/07)

National Grid (NTS) welcomes the opportunity to comment on the above consultation. Our response provides a summary of our main points below and a response to the specific questions in an Appendix.

Summary

We believe the document provides a fair representation of the discussions that took place as part of the Transmission Price Control Review.

Throughout the price control process, we outlined our principles with regards to the setting of baselines, namely that baselines should:

- reflect physical capability (in order to encourage timely investment signals and not expose consumers to huge buy-back costs);
- be commensurate with the buy-back target; and
- take into account sold capacity (baselines should not be set below existing capacity commitments).

We continue to believe that these principles are correct and particularly that the baselines should be set commensurate with the physical capability of the system. We believe this is consistent with the objectives set out by Ofgem and contained in Chapter 4 of the consultation document. As part of the debate through the TPCR process, we outlined the range of the physical capability of the system under different supply assumptions and included this within our response to Ofgem June 2006 Initial Proposals document. This analysis demonstrated that under certain credible supply scenarios, the baselines that were accepted as part of the price control were indeed above that physical capability, but given that baselines are part of the TPCR package, we chose to accept them. We believe correspondence and analysis provided during the TPCR remains valid for this re-consultation process.

The principle of setting baselines, and hence National Grid's obligations, commensurate with the physical capability of the system is a principle that is relevant in both the setting of the **aggregate** level of baselines and the nodal **allocation** of the aggregate baseline figures. We understand that the implications of increasing the **aggregate** level of baselines are to be considered in the Second Consultation document and are therefore not covered in any detail in this response.

Recent work undertaken in relation to transfer and trades identifies that certain **re-allocations** of capacity would not be at a 1:1 exchange rate. The information shared with Ofgem and the industry in relation to transfer and trades provides useful information (on a 2007/8 network) on where re-allocations of capacity between nodes would remain consistent with the physical capability of the system. We believe the options consulted upon by NGG NTS during August and September (contained in table 5.5 of the consultation document) are the options most consistent with allocations which are commensurate with the physical capability of the system. National Grid has no strong preference in relation to the options contained in table 5.5 but would wish to reserve the right to consider the risk profile associated with any change from the baselines accepted as part of the price control. Our initial view would however be that the options contained in table 5.5 would not materially change the risk profile accepted as part of the TPCR. Nodal allocations in line with Table 5.1 and 5.3 (which increase both the aggregate baseline level and the nodal allocation in constrained areas) would be inconsistent with setting baselines commensurate with the physical capability of the system and we therefore believe are not consistent with Ofgem's stated policies with regards to baselines.

In summary, it needs to be recognised that the distribution of the aggregate total (7629 GWh/d) is important. It shouldn't be assumed that a different distribution would provide the same risk profile to National Grid; it depends on where it is distributed. For example, Table 5.3 in Ofgem's document shows nodal baselines which still add up to 7629, but baselines of 1121 GWh/d at Easington and 1973 GWh/d at Bacton provide far more risk to National Grid than were those amounts of capacity distributed to entry points where it is unlikely to for gas supplies up to that level to materialise.

Whilst we recognise the Second consultation will concentrate on the implications of setting higher baselines we would highlight the following points at this stage of the consultation:

- We believe it is reasonably straightforward to calculate the additional TO capex allowance that would be commensurate with any increase in baselines. This additional allowance can be calculated based on the detailed work undertaken during the price control on setting nodal revenue drivers.
- Analysis can be undertaken on the range of potential buybacks associated with setting higher baselines and National Grid not investing to cater for future flows up to the new baseline levels. The analysis is likely to provide a large range of potential buyback costs with actual buyback costs being highly uncertain given the range of potential flow scenarios over the price control period.
- Any model which increases baselines would lessen the investment signals National Grid would receive through the long-term entry capacity auctions and undermine the user commitment model which was a key component to the TPCR final proposals. Consideration should be given to customers who have recently provided user commitment to provide incremental signals against the existing baselines.
- Any model which increases baselines needs to consider the interaction with the new obligations in relation to substitution and transfer and trades.

Our response to the specific questions contained in the consultation document are contained in the Appendix. In the meantime, we appreciate that the process is following a very tight timeline and will continue to work with Ofgem to provide any assistance we can in order to facilitate the process.

Yours sincerely,

Chris Bennett
Regulatory Frameworks Manager

Appendix – Response to Questions

Chapter 4

Question 1: Do you agree that the objectives of the TPCR baseline review were appropriate?

As mentioned in our executive summary we agree that the objectives of the TPCR baseline review were appropriate. Furthermore we believe the rationale for the objective to set baselines which would better reflect the physical capability of the system was also articulated, namely;

- To reduce the risks of high buyback costs having to be borne by consumers
- To reflect the fact that UK gas flows patterns might considerably change during the next five years
- To strengthen investment signals to NGG NTS through long-term entry capacity auctions.

Question 2: Do you agree that the modelling approach we asked NGG NTS to carry out was appropriate? If not, why not.

We believe the modelling approaches requested of National Grid were appropriate. They considered the range of credible options for reviewing baselines and ultimately concluded on the most relevant option of supply substitution.

Question 3: One of the main difficulties we faced in the run up to Final Proposals was to account for zonal constraints. Are there any better ways accounting for zonal constraints?

Taking into account the interaction between nodal capabilities and zonal constraints is clearly a key component in setting baselines in line with the stated objective of setting baselines which reflect the physical capability of the system. We believe that Ofgem's proposed baselines outlined within Initial Proposals and Updated Proposals did not recognise the zonal constraints within the system as the modelling was still being considered on a nodal basis. Although there are potential alternative ways of taking account of zonal constraints we believe the modelling in Final Proposals took a reasonable approach to taking account zonal constraints and remain the most appropriate method for this consultation.

Question 4: Are there any other issues we should have considered in this chapter?

Our key comments are contained in the executive summary.

Chapter 5

Question 1: Would you consider any of the alternative approaches for allocating the free increment as discussed in this chapter more or less appropriate than the approach adopted for the TPCR Final Proposals baselines? Please give your reasons.

As mentioned in our executive summary we believe that the options consulted upon by NGG NTS during August and September (contained in table 5.5 of the consultation document) are the options

most consistent with allocations which are commensurate with the physical capability of the system. National Grid has no strong preference in relation to the options contained in table 5.5 but would wish to reserve the right to consider the risk profile associated with any change from the baselines accepted as part of the price control. Our initial view would however be that the options contained in table 5.5 would not materially change the risk profile accepted as part of the TPCR. Nodal allocations in line with Table 5.1 and 5.3 would be inconsistent with setting baselines commensurate with the physical capability of the system.

It needs to be recognised that the distribution of the aggregate total (7629 GWh/d) is important. It shouldn't be assumed that a different distribution would provide same risk profile to National Grid; it depends on where it is distributed. For example, Table 5.3 in Ofgem's document shows nodal baselines which still add up to 7629, but baselines of 1121 GWh/d at Easington and 1973 GWh/d at Bacton provide far more risk to National Grid than were those amounts of capacity distributed to entry points where it is unlikely to for gas supplies up to that level to materialise.

Question 2: We allocated the Caythorpe and Blyborough (Welton) free increments to Hornsea and Theddlethorpe respectively, do you agree with this approach or should these free increments have been allocated in a different way and if so, how and why?

We believe the allocation of capacity at Caythorpe and Blyborough (Welton) to Hornsea and Theddlethorpe respectively to be somewhat arbitrary. However, National Grid ultimately accepted this re-allocation as part of the TPCR. The acceptability of any alternative allocation of the Caythorpe and Blyborough (Welton) capacity would need to be assessed against the physical capability of the system. We would not recommend any re-allocation to ASEPs where constraints are known to exist.

Question 3: NGG NTS presented three principles in order to allocated baseline capacity, namely to (i) allocate in line with physical capability; (ii) constrain not to exceed previous obligated levels; (iii) be broadly commensurate with the buyback target. Do you agree with these principles? Please explain why or why not.

We clearly support the 3 principles put forward by NGG NTS for the reasons outlined in the workshops. In addition, it should be noted that we also proposed that baselines should not be set below capacity which had already been sold.

Question 4: NGG NTS presented slightly different ways of reallocating entry capacity to different entry points. Would you find these approaches more or less appropriate? Please give your reasons.

Please refer to Question 1.

Question 5: Are there any other considerations which we have not highlighted which we should have taken into account?

Our key comments are contained in the Executive Summary

Chapter 6

Question 1: Is our approach for allocating the free increment, taking zonal constraints into account appropriate given the premise that baselines need to reflect the physical capability of the system?

As detailed earlier we believe taking account zonal and where necessary nodal constraints, is not only appropriate but necessary given the premise that baselines need to reflect the physical capability of the system in order to both provide appropriate investment signals to NGG NTS, but also to protect the interests of end consumers.

Question 2: Are there any other factors that we have not considered which should be assessed in considering an appropriate adjustment to baselines?

Our key comments are contained in the Executive Summary.

Question 3: What are your views on the different options outlined for allocating capacity in a different way, whilst maintaining aggregate baselines at the current TPCR Final Proposals level of 7629 GWh/d?

As mentioned in the Executive Summary we believe that the options consulted upon by NGG NTS during August and September (contained in table 5.5 of the consultation document) are the options most consistent with allocations which are commensurate with the physical capability of the system. National Grid has no strong preference in relation to the options contained in table 5.5 but would wish to reserve the right to consider the risk profile associated with any change from the baselines accepted as part of the price control. Our initial view would however be that the options contained in table 5.5 would not materially change the risk profile accepted as part of the TPCR. Nodal allocations in line with Table 5.1 and 5.3 would be inconsistent with setting baselines commensurate with the physical capability of the system and we therefore believe are not consistent with Ofgem's stated policies with regards to baselines.

It needs to be recognised that the distribution of the aggregate total (7629 GWh/d) is important. It shouldn't be assumed that a different distribution would provide same risk profile to National Grid; it depends on where it is distributed. For example, Table 5.3 in Ofgem's document shows nodal baselines which still add up to 7629, but baselines of 1121 GWh/d at Easington and 1973 GWh/d at Bacton provide far more risk to National Grid than were those amounts of capacity distributed to entry points where it is unlikely to for gas supplies up to that level to materialise.

Question 4: What are the advantages and disadvantages of keeping baselines unchanged at their current TPCR Final Proposals level?

One advantage of keeping the baselines unchanged at their current TPCR level is that it would ensure that the overall package of the price control, accepted by National Grid in December 2006, would remain intact. Clearly changing the baselines would re-open part of an accepted price control, which could be seen as an undesirable precedent, and would require further work to fully understand the impact. That said we have been fully supportive of the process to re-consult on baselines and would need to consider the overall package associated with any proposed change in baselines.

As mentioned in the executive summary we believe any increase in aggregate baselines or a significant re-allocation of capacity (not reflecting physical capability) would be inconsistent with the fundamental principles consulted upon during the TPCR.

Question 5: If we were to increase the aggregate baselines how could we quantify possible increases in buyback costs and/or capex allowance also given the timescales involved?

As mentioned in the Executive summary we believe it is reasonably straightforward to calculate the additional TO capex allowance that would be commensurate with any increase in baselines. This additional allowance can be calculated based on the detailed work undertaken during the price control on setting nodal revenue drivers. Analysis on buybacks is more difficult but can be undertaken on the range of potential buybacks associated with setting higher baselines and National Grid not investing to cater for future flows up to the new baseline levels. The analysis is likely to provide a large range of potential buyback costs with actual buyback costs being highly uncertain given the range of potential flow scenarios over the price control period.

We will endeavour to work with Ofgem to undertake any analysis requested recognising the timescales involved.

Question 6: If we were to increase the aggregate baselines how should we allocate the additional capacity? Which mechanism, if any, should we use?

As mentioned earlier we would not propose an increase in aggregate baselines. However, in the event that aggregate baselines were increased, the allocation of additional capacity would need to be consistent with the total TO Capex Allowance or the buyback target. As indicated by the revenue drivers, accepted as part of the TPCR, additional capacity at different entry points would required a greater TO Capex Allowance.

Question 7: Are there any other considerations which we have not highlighted which should be taken into account if we were to increase aggregate baselines?

Our key comments are contained in the Executive Summary.