



System Operators,
Transportation System Owners,
Shippers, Suppliers, Customers
and Other Interested Parties

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value for all customers*

Your Ref:
Our Ref:
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Date: 11 August 2008

Dear Colleague

National Grid Gas System Operator Incentives from 1 April 2008: Environmental Incentive - Methane Emissions: amendment of Final Proposals

National Grid Gas (NGG) is the System Operator (SO) for the gas transportation system. The SO is responsible for ensuring the safe, secure and economic operation of the gas system.

NGG is incentivised in a number of areas of its SO role (including shrinkage volumes, residual balancing and the provision of information). We have recently been working with NGG to develop a new environmental incentive relating to methane emissions.

NGG issued its initial proposals¹ for an incentive related to compressor venting on 2 May 2008; this consultation closed on 30 May 2008. On 3 July 2008 the Authority published a notice under section 23 of the Gas Act 1986 (the "Notice") setting out a proposed licence modification in this respect. This incentive was intended to apply from 1 April 2008.²

The proposed licence modification set out in the Notice was based on historic venting data provided, and consulted on, by NGG. The incentive target was expressed to apply in relation to all compressors (and therefore covered both electric driven and gas turbine driven compressors).

However, it has come to our attention that NGG does not currently measure the methane vented from electricity driven compressor units. Accordingly, the methane incentive target ought only to apply to gas turbine driven compressors.

The Authority is therefore issuing a new section 23 notice (which can be found in the Appendix to this letter) setting out a proposed environmental incentive on methane emissions which is the same as the incentive proposed in the Notice save for the following, new definition of "compressor":

¹ National Grid Gas (NTS) SO Environmental Incentive: Initial Proposals Consultation, NGG, 2 May 2008.

² In our Final Proposals document we noted our intention to work closely with NGG to derive a forecast target volume for compressor venting, such that an incentive could be applied retrospectively from 1 April 2008.

"compressor" means gas turbine driven plant forming part of the pipe-line system to which this licence relates that is used by the licensee to increase the pressure of gas in part of that pipe-line system.

We received one response to the Notice, from Scottish and Southern Energy (SSE), which is available on the Ofgem website³. SSE expressed concern that the target was based on a seven year historical average and therefore would not account for NGG's plans to introduce electric compressors. SSE stated that this could potentially lead to a significant reduction in methane emissions this year and a windfall gain under the proposed incentive. We have noted SSE's comment and believe the concern would need to be covered in incentives for future years but given NGG's limited plans to replace compressors during 2008/09 we do not consider that it is a material issue for 2008/09. In addition, NGG has informed us that the amount of methane vented from gas driven compressors is not materially different from electricity driven compressors. The Authority will request information from NGG on its plans to replace gas turbine driven compressors and measure venting from electricity driven compressor units to inform the setting of next year's incentive.

The statutory notice attached to this letter specifies a period of not less than 28 days during which interested parties can make representations or objections to the proposed licence modification, and during which the Secretary of State may direct the Gas and Electricity Markets Authority (the Authority) not to make the proposed modification. Following any such representations, objections or direction, the Authority may make such revisions to the proposed licence modification as it considers appropriate and carry out a further statutory consultation on the new proposed licence modification.

Provided that NGG consents to the implementation of the proposed licence modification, and subject to any representations made during this consultation and any direction received from the Secretary of State, the modification will be implemented retrospectively from 1 April 2008.⁴

We would welcome the views of interested parties in respect of the proposal set out in this letter. Responses should be sent to GB.markets@ofgem.gov.uk to be received no later than 8 September 2008 marked for the attention of:

Andrew Wright
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Should you wish to discuss any aspects of this letter, Alessandro Rubino (020 7901 7311) would be pleased to help. Email alessandro.rubino@ofgem.gov.uk.

Yours sincerely



Andrew Wright
Managing Director, Markets

³ <http://www.ofgem.gov.uk/Markets/WhlMkts/EffSystemOps/SystOpIncent/Pages/SystOptIncent.aspx>

⁴ Should NGG not consent to the proposed modification, the Authority can refer the matter to the Competition Commission.