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Date: 17 May 2010

Dear colleague

**Notice under section 23 of the Gas Act 1986 – Proposed modification to Special Condition C15 of National Grid’s Gas Plc’s National Transmission System Gas Transporter Licence**

The Authority has consulted on a proposed modification to Special Condition C15 of National Grid Gas’s (NGG’s) Gas Transporter Licence (the “Licence”)<sup>1</sup>. This consultation sought views on NGG’s proposed amendment to Special Condition C15 – NGG has proposed to change the submission date of the Incremental Entry Capacity Release (IECR) methodology statement (the “Statement”) from ‘before 1 July in each formula year’ to ‘before 7 November in each formula year’.

Having considered the responses to our consultation and having regard to the principal objective and statutory duties of the Authority and for the reasons set out in this letter, the Authority is now proposing to modify the submission date of the Statement.

This letter outlines:

- The background to the proposed modification including why it has been proposed;
- The proposed modification;
- Responses to our initial consultation on the proposed modification; and
- Ofgem’s views on amending the Licence.

**Background**

NGG are required to auction entry capacity at the Quarterly System Entry Capacity (QSEC) auction. At this auction Shippers can choose to bid for incremental entry capacity at any Aggregated System Entry Point (ASEP). If Shippers signal for the release of incremental entry capacity, NGG will undertake a Net Present Value (NPV) calculation to determine if the incremental entry capacity should be released.

The IECR methodology statement describes how the NPV calculation is carried out and when NGG can make incremental capacity available if a signal for incremental capacity passes the test. The statement also describes both the methodology for calculating project costs to provide incremental entry capacity at each ASEP, and how the incremental price steps, which NGG must publish two months before the QSEC auction takes place, are set.

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<sup>1</sup> The informal consultation on changes to the submission date of the Incremental Entry Capacity Release (IECR) methodology statement is available on the Ofgem website: <http://www.ofgem.gov.uk>

Paragraph 2 of Special Condition C15 of the Licence requires NGG to submit the Statement to the Authority for approval before 1 July in each formula year. Unless the Authority consents otherwise, the Statement must be accompanied by an audit report confirming the extent to which the licensee has developed a methodology that is consistent with the licensee's duties<sup>2</sup>.

Paragraph 4 of Special Condition C15 allows the Authority a 2 month period to veto the proposed changes to the statement from the date of submission.

## **Consultation**

On 6 April 2010 we issued a consultation on modifying the submission date of the Statement from before 1 July to before 7 November in each formula year. In the consultation we set out Ofgem's initial view that this revision would align the submission of the Statement with the recently changed<sup>3</sup> March QSEC timetable, thereby allowing NGG to better match their internal work processes to the auction period and provide appropriate information to system users in time for the auction occurring.

We also noted that the revised date would increase the amount of time the Authority has to consider proposed changes to the Statement. This should lead to a more considered analysis of the statement, especially if significant changes are proposed.

## **Consultation responses**

We received two responses to the consultation. A copy of these responses can be found on the Ofgem website<sup>4</sup>. Both respondents agreed with our proposed revision to the Statement submission date and the reasons given for the proposed change.

One of the respondents, NGG, also made a number of other comments in respect of the timing and extent of the proposed changes. Whilst the comments were not in relation to the proposed Licence modification in the consultation they are noted here for reasons of transparency. Our response to these comments can be found in the 'Ofgem's views' section below.

First, NGG note that the submission of the Statement must be accompanied by an audit report confirming the extent to which the licensee has developed a methodology that is consistent with the licensee's duties. However, NGG can request a derogation from the Authority not to submit this audit report should only non substantial changes be made to the methodology.

Second, NGG stated that it would prefer the Licence to be amended so that it is only required to undertake the audit if directed by the Authority. It considered that this would align Special Condition C15 with the equivalent obligation for exit capacity in Special Condition C18 'Licensee's methodology for determining the release of NTS exit capacity volumes'.

Third, NGG state they would have preferred the submission of the audit report to be decoupled from the IECR methodology statement so that it is submitted to the Authority at a later date. NGG believe this could give the Authority more time to consider changes to the IECR methodology statement as the start date for the audit is constrained by availability of charging model data.

Finally, they note that if the QSEC auction is held on 1 March rather than mid-March, the Authority will not have a full two month period to consider the Statement.

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<sup>2</sup> See paragraph 3 Special Condition C15 of the Licence.

<sup>3</sup> See decision to implement UNC230AV on the Joint Office website [www.gasgovernance.co.uk](http://www.gasgovernance.co.uk)

<sup>4</sup> [www.ofgem.gov.uk](http://www.ofgem.gov.uk)

## **Ofgem's view**

Having considered the responses to the consultation we have decided to proceed with the proposal of modifying the submission date for the IECR methodology statement in paragraph 2 of Special Condition C15 from before 1 July to before 7 November in each formula year.

We note NGG's further comments in their response. We are content that the revised date would give the Authority sufficient time to consider proposed changes to the Statement before approval or veto is required. The current submission date only allowed the Authority, in practice, a two week period to consider revisions to the Statement. The revised submission date would make sure that the Authority would have between six weeks to two months (the maximum period permitted by the Licence).

We acknowledge NGG's preference to change the automatic assumption that an audit report be undertaken and to decouple that audit report from the submission of the Statement so that it is aligned with the Exit Capacity Release (ExCR) methodology statement. In the past, audits have assessed the extent to which the transportation model (which is used to set entry capacity prices) reflects what is stated in the IECR methodology. If there are substantive changes to the IECR methodology, our preference is for that audit to be submitted alongside the Statement. This ensures that the Authority has access to all relevant information when considering revisions to the Statement, as the audit report is a useful tool to assess whether these changes have been appropriately implemented in the transportation model. If no substantive changes are proposed then in our view, it is not time-consuming or onerous for NGG to seek a derogation if they consider an audit is not required. This would also be our preferred default position for reviewing the ExCR methodology statement, however, this licence modification proposal is only concerned with arrangements governing the review of the IECR methodology statement.

## **Proposed modification**

Subject to consideration of any representations or objections to the notice of proposed modifications outlined above and attached and having regard to the Authority's principal objective and statutory duties, the Authority proposes to modify the Licence as per the accompanying notice.

The proposed licence modification to paragraph 2 of Special Condition C15 is set out in Schedule A to the Notice that accompanies this letter. As confirmed in the Notice, any representations or objections should be made to Ofgem by 15 June 2010. Subject to any representations and NGG's consent, Ofgem aims to modify the licence during June 2010.

If you have any comments or questions on this letter, please contact James Thomson on 0141 331 6012 or [james.thomson@ofgem.gov.uk](mailto:james.thomson@ofgem.gov.uk) in the first instance.

Yours sincerely



Stuart Cook  
**Senior Partner, Transmission & Governance**