



National Grid Gas, gas shippers
and other interested parties

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all gas and electricity customers*

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Dear Colleagues

Gas shipper entry credit arrangements

Uniform Network Code (UNC) modification proposal UNC246¹ was originated in order to address perceived deficiencies with the gas shipper credit arrangements underpinning the reservation of capacity through the long-term entry capacity auctions. Ofgem recently issued a decision² not to implement UNC246 or its variants, as it considered that the proposals did not better facilitate the relevant objectives. This decision has led to requests from industry for guidance on the way forward with respect to entry capacity credit arrangements.

UNC246 was targeted at two issues:

- The ability of single entry point shippers to default on their capacity credit requirements without any further penalty being incurred by them; and
- The length of time between the shipper signalling for capacity and its requirement to post credit against that capacity booking.

In our decision, we noted that we agreed with the principle being proposed to address the first of these issues and suggested that industry should come forward with a further proposal to specifically address the current shortcomings. We note that to date, no such proposal has been brought forward for discussion by industry.

With respect to the second issue, we would reiterate our position; it is up to the transporter to ensure that the credit arrangements adopted for long-term supply contracts are reasonable and in line with commercial best practice.

These credit issues have been brought to prominence due to the set of circumstances surrounding the Fleetwood entry point. In order to secure entry capacity at Fleetwood, Canatxx, a US based development company, gave a signal for 650GWh/day of incremental capacity through the September 2006 Quarterly System Entry Capacity (QSEC) auction. This will result in National Grid Gas (NGG) taking on an obligation to provide 650GWh/d of entry capacity at Fleetwood from October 2010. Canatxx's signal was made in advance of their storage project being granted planning permission. Planning permission for this project was refused, and in October 2007 an appeal was rejected by the Secretary of State. Earlier in 2010 Canatxx lost another appeal on this decision, and so there is no requirement for the capacity previously signalled at Fleetwood for the foreseeable future.

¹ Quarterly NTS Entry Capacity User Commitment, Modification Reference Number 0246/0246A/0246B

² Ofgem decision letter dated 3 June 2010

In light of Canatxx's difficulties associated with obtaining the appropriate planning permissions for the storage project, NGG appear to have deferred committing to the bulk of the expenditure that would have been required to make the necessary reinforcements to the NTS. This behaviour is in keeping with their requirement to be economic and efficient in developing the NTS. However, the licence still allows NGG to benefit from the full incentive revenue for the provision of this capacity; in the event that Canatxx default on paying for this capacity, this revenue could be obtained through a smearing of capacity revenues due across the System Operator commodity charge. Ofgem expects to review the appropriateness of these licence conditions during the next transmission price control review.

Some shippers consider that this revenue would constitute a windfall gain for NGG, and have indicated an interest in challenging the appropriateness of this revenue allocation through giving notice of an Income Adjusting Event ("IAE") for the Authority to determine. However, the licence condition by which they had expected to mount such a challenge³ contains drafting errors making it difficult, if not impossible, for shippers to operate the clause. This is because the ability of shippers to give notice of an IAE is largely dependent being able to claim there has been a substantive increase or decrease to the value of "relevant system operation costs"; however, this term remains undefined in the licence. Therefore, we intend to consult on remedying the errors in the IAE provisions, in line with the proposal in Appendix A. We would expect the outcome of the consultation to be implemented before October 2010.

In advance of this licence consultation, we would welcome views from interested parties on the appropriateness of the proposed action along with any input on the specific definition of "relevant system operation costs" or the IAE provisions generally, that could rectify the perceived defect. Comments would be welcome by 26th August 2010. If there are any comments or questions on this letter, please contact Paul O'Donovan at +44 20 7901 7414 or by e-mail at paul.odonovan@ofgem.gov.uk in the first instance.

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³ Special Licence Condition C8C 3 (b) of the Gas Transporter Licence

Appendix A –Income Adjusting Event Licence Condition

1.1. Special Condition C8C 3 (a) of the Gas Transporter Licence sets out the formula for determining the maximum NTS system operation revenue. This formula states that the maximum revenue may be adjusted in respect of an income adjusting event (IAE), whether by a positive or a negative amount. Special Condition C8C 3 (b) set out provisions relating to IAEs.

1.2. Under C8C 3(b) (ii), the licensee must give notice to the Authority where it considers that costs or expenses have been incurred or saved by an IAE and can provide supporting evidence of this. Under C8C 3(b) (iii), any shipper may give notice of an IAE to the Authority where it considers that costs and expenses have been incurred or saved and it can provide supporting evidence of this.

1.3. Special Condition C8C 3 (b) (i) sets out how an IAE may arise. There are four types of event that may trigger an IAE:

- A force majeure event or circumstance;
- The declaration of a network gas supply emergency;
- Where the licensee serves a termination notice on a shipper and there is a consequential shortfall in revenues; and
- Any other event or circumstance which, in the Authority's opinion, is an IAE and which the Authority approves as such following consultation with parties likely to be affected by its decision.

1.4. In relation to the first and last of these types of IAE, the event must have either: increased or decreased the value of "relevant system operation costs" by more than £2m (the "threshold amount") for the relevant formula year; or increased or decreased the value of IOC_t or ICE_t by more than £1m ("the internal threshold amount").

1.5. The licence refers to "relevant system operation costs" as "...having the meaning given to that term in Special Condition C8A (Revenue restriction definitions in respect of the **NTS transportation owner activity** and **NTS system operation activity** [*our emphasis*]))". However, the term is currently undefined in the licence.

1.6. We have reviewed the original licence drafting notes associated with this condition from the time of the last price control. Since both of the bold terms above are already defined in the licence, we believe the "relevant system operation costs" definition was (incorrectly) deemed unnecessary as it would have been replicating existing definitions.

1.7. In order to correct this omission, we are proposing the following definition should be added to the licence in C8A:

"relevant system operation costs" means those costs associated with the licensee's conduct of NTS system operation activity and/or NTS transportation owner activity

1.8. In addition to the above, we propose making some corrections to licence condition C8C 3 (b) to correct manifest errors as follows:

Clause (vii): insert the words "the notice and supporting evidence and information" which appear to be missing.

Clause (ix) (B): insert missing wording to clarify that the Authority should consider whether the event has increased or decreased the value of relevant system operation costs by more

than the threshold amount or has increased or decreased the value of IOC_t or ICE_t by more than the internal threshold amount.

A change marked version of the revised licence condition wording is attached as Appendix B.

Appendix B – Proposed draft changes to Special Licence Condition C8C 3 (b)

(Change Marked version)

(b) Determination of any adjustment factor to be applied to maximum NTS system operation revenue ($SORA_t$)

- (i) An income adjusting event may arise from any of the following:
- (A) an event or circumstance constituting force majeure under the network code;
 - (B) an event or circumstance resulting in the declaration of a network gas supply emergency (having the meaning given to such term in the network code);
 - (C) where the licensee serves a termination notice (having the meaning given to that term in the network code) on a gas shipper and the revenues derived by the licensee from the sale of that obligated entry capacity are less than the revenues that would have been derived from the original sale of that capacity had the original purchaser of the capacity not been served with a termination notice (having the meaning given to that term in the network code); and
 - (D) an event or circumstance other than listed above which is, in the opinion of the Authority, an income adjusting event and is approved by it as such in accordance with paragraph 3(b)(ix) of this condition,
- where the event has, for relevant formula year t:
- (aa) increased or decreased the value of “relevant system operation costs” (having the meaning given to that term in Special Condition C8A (Revenue restriction definitions in respect of the NTS transportation owner activity and NTS system operation activity)) by more than £2,000,000 (the “threshold amount”). This threshold amount does not apply in respect of sub-paragraphs 3(b)(i)(B) or 3(b)(i)(C) above; or

(bb) increased or decreased the value of IOC_t (having the meaning given to that term in paragraph 1(b) of Special Condition C8G (NTS system operator internal incentives, costs and revenues)) or ICE_t (having the meaning given to that term in paragraph 1(c) of Special Condition C8G (NTS system operator internal incentives, costs and revenues)) by more than £1,000,000 (the "internal threshold amount") and is demonstrably not included in $IOIT_t$ or $ICET_t$ respectively (having the meaning given to those terms in paragraphs 1(b) and 1(c) of Special Condition C8G (NTS system operator internal incentives, costs and revenues) respectively) for formula year t. This internal threshold amount does not apply in respect of sub-paragraphs 3(b)(i)(B) or 3(b)(i)(C) above.

- (ii) Where the licensee considers, and can provide supporting evidence that, in respect of relevant formula year t, there have been costs and/or expenses that have been incurred or saved by an income adjusting event, then the licensee shall give notice of this event to the Authority.
- (iii) Where any shipper considers, and can provide supporting evidence that, in respect of formula year t, there have been costs and/or expenses that have been incurred or saved by an income adjusting event, then that shipper may give notice of this event to the Authority.
- (iv) A notice provided to the Authority under paragraphs 3(b)(ii) or 3(b)(iii) shall, in the case of the licensee, and should in so far as is practicable in the case of any shipper, give particulars of:
 - (A) the event to which the notice relates and the reason(s) why the person giving the notice considers this event to be an income adjusting event;
 - (B) the amount of any change in costs and/or expenses that can be demonstrated by the person giving the notice to have been caused or saved by the event and how the amount of these costs and/or expenses has been calculated;

- (C) the amount of any allowed income adjustment proposed as a consequence of that event and how this allowed income adjustment has been calculated; and
 - (D) any other analysis or information which the person submitting the notice considers to be sufficient to enable the Authority and shippers to fully assess the event to which the notice relates.
- (v) If the Authority considers that the analysis or information provided in sub-paragraphs 3(b)(iv)(A) to 3(b)(iv)(D) above is insufficient to enable both the Authority and shippers to assess whether an income adjusting event has occurred and/or the amount of any allowed income adjustment that should be approved, the Authority can request that the supporting evidence be supplemented with additional material that it considers appropriate.
- (vi) A notice of an income adjusting event shall be given as soon as is reasonably practicable after the occurrence of the income adjusting event, and, in any event, not later than three months after the end of the relevant formula year t in which it occurs.
- (vii) The Authority will make public [the notice and supporting evidence and information](#), excluding any confidential information, which it has received under paragraph 3(b)(ii) or 3(b)(iii) of this condition.
- (viii) Any notice submitted to the Authority under either paragraphs 3(b)(ii) or 3(b)(iii) above shall clearly identify whether any of the information contained in the notice is confidential information. The Authority shall make the final determination as to whether the information is confidential information for the purpose of paragraph 3(b)(vii) having regard to:
- (A) the need to exclude from disclosure, so far as is reasonably practicable, information whose disclosure the Authority considers would or might seriously prejudicially affect the interests of a person to which it relates; and
 - (B) the extent to which the disclosure of the information mentioned in sub-paragraph 3(b)(viii)(A) is necessary for the purpose of enabling shippers to fully assess the event to which the notice relates.

- (ix) Following consultation with such parties as the Authority considers likely to be affected by its determination, including the licensee and shippers, the Authority shall determine:
- (A) whether any or all of the costs and/or expenses referred to in a notice pursuant to paragraphs 3(b)(ii) or 3(b)(iii) of this condition were incurred or saved as a result of an income adjusting event;
 - (B) whether the event or circumstance has increased or decreased the value of relevant system operation costs (having the meaning given to that term in Special Condition C8A (Revenue restriction definitions in respect of the NTS transportation owner activity and NTS system operation activity)) by more than the threshold amount or has increased or decreased the value of IOC_t or ICE_t (having the meaning given to those terms in paragraphs 1(b) and 1(c) of Special Condition C8G (NTS system operator internal incentives, costs and revenues) respectively) by more than the internal threshold amount, save in the case of sub-paragraphs 3(b)(i)(B) and 3(b)(i)(C) where the threshold amount and internal threshold amount shall not apply; and
 - (C) if so, whether the amount of the proposed income adjustment ensures that the financial position and performance of the licensee are, insofar as is reasonably practicable, the same as if that income adjusting event had not taken place, and if not, what allowed income adjustment would secure that effect.
- (x) In relation to formula year t , the approved allowance in respect of an income adjustment ($SORA_t$) shall be:
- (A) the value determined by the Authority under paragraph 3(b)(ix) of this condition; or
 - (B) if the Authority has not made a determination under paragraph 3(b)(ix) of this condition within three months of the date on which the notice of an income adjusting event was provided to the Authority, the amount of the allowed income adjustment proposed as a consequence of the event in the notice given to the Authority under paragraph 3(b)(iv)(C); or

- (C) in all other cases zero, including situations where the Authority has not made a determination under paragraph 3(b)(ix) of this condition within three months of the date on which notice under paragraphs 3(b)(ii) or 3(b)(iii) was provided to the Authority and the Authority has, before the end of that three month period, informed the relevant parties that the Authority considers that the analysis or information provided in accordance with paragraphs 3(b)(iv) and/or 3(b)(v) is insufficient to enable the Authority and shippers to assess whether an income adjusting event has occurred and/or the amount of any allowed income adjustment.
- (xi) The Authority's decision in relation to any notice given under paragraphs 3(b)(ii) or 3(b)(iii) shall be in writing, shall be copied to the licensee and shall be published.
- (xii) The Authority may revoke an approval of an income adjusting event and allowed income adjustment with the consent of the licensee, following consultation with the licensee and shippers. Revocation of any income adjusting event and allowed income adjustment shall be in writing, shall be copied to the licensee and shall be in the public domain.