Stuart Cook
Senior Partner
Transmission and Governance
Ofgem
9 Millbank
London
SW1P 3GE

Mark Ripley
Regulatory Frameworks Manager
National Grid Transmission
mark.g.ripley@uk.ngrid.com
Direct tel. +44 (0)1926 654928

www.nationalgrid.com

25 August 2010

Our Reference MR/Ofgem/104/10

Dear Stuart,

"Gas shipper entry credit arrangements" Ofgem Open Letter 4th August 2010

Thank you for the opportunity to respond to the above Ofgem open letter.

National Grid NTS agrees with Ofgem's analysis that the licence drafting contains an error in the area of Income Adjusting Events (IAE) in that one of the possible triggers is defined as an event that has '*increased or decreased the value of "relevant system operation costs" '*, and the licence does not define this term.

The letter also makes a specific link to the Fleetwood incremental entry capacity incentive revenue and the refusal of planning permission for the associated Canatxx storage project and says that Ofgem "expect to review the appropriateness of these licence conditions during the next price control". We understand that this may mean a review of the rules as to when incremental allowed revenue is released as a result of an auction signal and what happens to the capacity following either a shipper default or a delay to an associated supply project. We agree that it is appropriate to review the purpose and application of the revenue driver incentive arrangements as part of the forthcoming price control discussions.

We are also aware that some shippers consider that the Fleetwood revenue represents a "windfall gain" and that a shipper is not currently able to challenge the appropriateness of the revenue allocation through an IAE. The suggested clarification of "relevant system operator costs" that is being consulted upon could pave the way for a shipper to raise such an IAE.

We are concerned that any changes to the IAE arrangements might undermine the Licence incentive arrangements. National Grid accepted the price control package, including the associated deep incentive schemes, in its entirety and the various SO Incentive schemes, including the entry capacity investment scheme, have resulted in a combination of under and over performance. Whilst we agree that, to date, we have invested less in respect of the Fleetwood project than the allowed revenue, there are also schemes where we have invested more than the allowed revenue. Examples of this include Easington, Isle of Grain Phase 2, and Milford Haven where capex costs have significantly exceeded the costs implied by our allowed revenue. National Grid strongly believes that if there is to be any form of review of the appropriateness of allowed revenue, this should consider the entire SO entry capacity investment incentive scheme and not focus on a single entry point in a piecemeal way through an IAE process.

We would also stress that simply taking incentive revenue away via an IAE will still leave significant ambiguity should planning permission be granted for a facility connected at Fleetwood or should a similar situation arise at another entry point. This remains a credible outcome as a new company, Halite Energy Group, has recently taken over the Fleetwood project with the intention of gaining planning consent and using the facility for the storage of gas. The obligation on National Grid to make capacity available at Fleetwood via all relevant entry capacity auctions would continue to exist and capacity could be acquired relatively cheaply on a within-day basis at the Fleetwood entry point. This would then leave National Grid with the risk but no revenue, and the possibility of a further National Grid led IAE to obtain appropriate funding. This does not feel like a sensible outcome and National Grid therefore suggests that a more appropriate solution would be a more fundamental review of how the licence works and that, as indicated by Ofgem, this should be incorporated within the price control review.

The proposed definition for "relevant system operator costs" may allow for an IAE to be raised for any SO incentive scheme under or over performance beyond the IAE defined thresholds; however, we recognise that excluding variation in SO incentive scheme related costs might prevent an IAE being raised in relation to Fleetwood. Any Licence changes and review of the arrangements should take this into account.

We note that the IAE mechanism within the licence relates to a one-off event, and not an ongoing situation, and that as stated in standard condition C8C 3(b) (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."*. This suggests that the refusal of planning permission for the Canatxx facility could not be a valid event under the Licence as it occurred in formula year 2009/10. It also suggests that should an IAE be defined in relation to Fleetwood entry investment incentive performance for formula year 2010/11, separate IAEs would also need to be raised for 2011/12 and 2012/13[1].

In summary, National Grid is in support of changes to the Licence that remove ambiguity but questions whether the proposed change would achieve this objective, and more fundamentally whether it is appropriate to effectively review the outcome of the 2002-07 price control through the use of the IAE mechanism.

Please do not hesitate to contact me if you wish to further discuss any aspect of this response.

Yours sincerely,

Mark Ripley

Regulatory Frameworks Manager

CC Paul O'Donovan

[1] Treatment of SO Entry Capacity Investment Incentive Revenue for 2012/13 would need to be clarified as part of the 2012/13 price control roll-over.