



National Grid Gas, gas shippers
and other interested parties

*Promoting choice and value for
all gas and electricity customers*

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Date: 28 October 2010

Dear Colleague

Re: Notice under Section 23 of the Gas Act 1986 - Special Condition C8A and C8C 3 (b) of National Grid Gas's National Transmission System (NTS) Gas Transporter licence.

(Responses requested by 25 November 2010)

Background

In the September 2006 Quarterly System Entry Capacity (QSEC) auctions the development company Canatxx¹ signalled a requirement for 650GWh/day of incremental capacity at the Fleetwood Aggregate System Entry Point (ASEP) for a major storage project. As a result, National Grid Gas (NGG) took on the obligation to provide the necessary entry capacity on the National Transmission System (NTS).

Canatxx's signal was made in advance of their storage project being granted planning permission and this was subsequently refused despite a number of appeals. In the light of these planning problems, NGG appears to have deferred the bulk of expenditure required to deliver the necessary entry capacity. This behaviour would be in keeping with their requirement to be economic and efficient in developing the NTS. However, NGG's licence still allows it to benefit from the full incentive revenue for the provision of the signalled capacity. In the event that Canatxx defaults on paying for its capacity bookings, this revenue could be obtained through a smearing of capacity revenues due across the System Operator commodity charge.

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 in considering this issue it has become apparent that the current drafting of the relevant licence provisions at Special Conditions C8A and C8C 3(b) are deficient. A particular difficulty is that because the term "relevant system operating costs" is not defined in Special Condition C8A, it is hard to establish that there has been a substantial increase or decrease in its value as required in C8C 3(b). Thus the licence does not fulfil its intended form and function at the time of the last price control settlement.

¹ The project has since been acquired by the Halite Energy Group

On 4 August 2010 we published an informal consultation² asking for views on proposed changes to those licence provisions that would:

- define “relevant system operation costs” in Special Condition C8A; and
- rectify manifest errors in Special Condition C8C 3 (b).

We also indicated that we expected to review the appropriateness of the existing licence conditions during the next transmission price control review and asked for suggestions of alternative actions that could rectify the perceived defects with the IAE provisions.

Respondents’ views

We received seven responses to our informal consultation and these are published on our website. Five respondents supported the licence changes, one respondent supported the principle of clarifying the licence, and one respondent made no specific comment on the proposed licence changes.

While the majority of respondents were in favour of the proposed changes, they raised a number of issues. One respondent suggested that additional changes should be made to remove both the need to identify a trigger date and the time limit by which an IAE has to be raised. Another supported the proposals on the basis that network companies should be held revenue neutral to issues outside of their control, whether they impose positive or negative effects. Given the licence errors identified in the proposals, the respondent considered that the licence conditions needed to be amended to facilitate such revenue corrections.

Three respondents raised issues regarding regulatory certainty and whether it was appropriate to allow a mid price control review of the revenues associated with the Fleetwood project. These three considered it would be more appropriate to take corrective actions at the time of the next price control, with the licensee adding that such a review should necessarily deal with other projects where it had incurred costs above their revenue allowance. The licensee also noted that the original capacity release obligations remain with it, and that these constitute a significant risk going forward.

Another respondent in support of the amendment suggested that it would be beneficial for Ofgem to clarify whether Shippers would be expected to raise an IAE for each formula year when the revenue driver was incurred or whether a single IAE would be sufficient to cover the relevant period. The licensee had also considered this issue, commenting that it believed separate annual IAEs would be required if shippers wished to address the incentive revenues associated with the Fleetwood project. It commented that it was in favour of changes which removed ambiguity from the licence, but questioned whether the proposals would achieve that objective.

Ofgem’s view

We have carefully considered the responses and have made no further changes to the proposed licence text. We believe that the proposed changes will serve to clarify the licence provisions by defining a currently undefined term and addressing manifest errors in C8C 3 (b). This should restore the licence to its intended form and function at the time of the last price control settlement, which has always been the intention of these proposals. We consider it would be inappropriate to alter the conditions to any further degree, as this could be seen as reopening the price control, and other changes could alter the balance of the licensee’s risk profile above and beyond that intended at the last settlement.

We note the concerns expressed by respondents regarding regulatory certainty, but we would contend that these proposals do not alter the nature of the current price control; rather, they seek only to correct a drafting deficiency which, if left uncorrected, would have the effect of distorting or preventing the intended operation of the price control. Rectifying

² “Gas shipper entry credit arrangements”, Ofgem open letter, 4 August 2010

the licence allows the shippers to submit a notice of an IAE if they so wish and for any such notice to be considered by the Authority as provided under Special Condition C8C 3(b). Should a shipper provide notice of an IAE following modification of the licence, we would consider the notice on its merits. Without fettering the Authority's discretion in any such determination, we would expect issues such as the residual risk of the licensee in relation to the Fleetwood capacity obligation to be factored into its considerations.

Change proposal

As described in the attached Section 23 Notice, we are proposing two changes to the existing gas transmission licence:

1. that 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
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2. that changes be made to C8C 3 (b) as indicated in Schedule A.

Any representations or objections to the proposed licence modification may be made in writing on or before 25 November 2010 and sent to:

Stuart Cook
Senior Partner, Smarter Grids and Governance
Ofgem
9 Millbank
London SW1P 3GE

Email responses should be sent to:

gas.transmissionresponse@ofgem.gov.uk

All responses will normally be published on Ofgem's website and held in the Research and Information Centre. However, if respondents do not wish their response to be made public then they should clearly mark their response as not for publication. Ofgem prefers to receive responses in an electronic form so they can be placed easily on the Ofgem website.

If you have any comments or questions on this letter please contact Paul O'Donovan on +44 20 7901 7293 or gas.transmissionresponse@ofgem.gov.uk in the first instance.

Yours sincerely,

Stuart Cook
Senior Partner, Smarter Grids and Governance.