

Stuart Cook
Senior Partner, Smarter Grids & Governance
Office of Gas and Electricity Markets
9 Millbank
London
SW1P 3GE

Paul Whittaker
UK Director of Regulation

paul.whittaker@uk.ngrid.com
Direct tel +44 (0)1926 653190
Direct fax +44 (0)1926 656520

www.nationalgrid.com

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Dear Stuart

Notice of proposed modification of Special Conditions C8A and C8C 3 (b) of National Grid Gas's gas transporter licence in respect of the National Transmission System (the "NTS licence") under Section 23 of the Gas Act 1986

I refer to the notice (the "Notice") given by the Gas and Electricity Markets Authority on 28 October 2010 pursuant to Section 23 of the Gas Act 1986 (the "Act") that it proposes to modify Special Condition C8A the NTS licence in the manner set out in the Notice and Special Condition C8C in the manner set out in Schedule A to the Notice.

I confirm that, for the purposes of Section 23 of the Act, National Grid Gas plc hereby consents to the modification of its NTS licence in the manner specified in the Notice and in Schedule A to the Notice.

I am aware that some shippers consider that the Fleetwood revenue represents a "windfall gain" and that, without this change to the NTS licence, a shipper may not be able to challenge the appropriateness of the revenue allocation through an IAE. The clarification of "relevant system operator costs" could pave the way for a shipper to raise such an IAE; however National Grid has some concerns over possible implications of this approach which are set out in the attached addendum.

Yours sincerely

[By E-mail]

Paul Whittaker
UK Director of Regulation

cc: Paul O'Donovan

Addendum

Notice of proposed modification of Special Conditions C8A and C8C 3 (b) of National Grid Gas's gas transporter licence in respect of the National Transmission System (the "NTS licence") under Section 23 of the Gas Act 1986

National Grid Gas ("National Grid") is aware that some shippers consider that the Fleetwood revenue represents a "windfall gain" and that, without this change to the NTS licence, a shipper may not be able to challenge the appropriateness of the revenue allocation through an IAE. The clarification of "relevant system operator costs" could pave the way for a shipper to raise such an IAE.

National Grid strongly believes that this change to the IAE arrangements should not be allowed to undermine the incentive arrangements in the NTS licence. National Grid accepted the price control package, including the associated deep incentive schemes, in its entirety. 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 the costs we have incurred to date as part of the initial phases of the Fleetwood related NTS reinforcement projects, have been less than the Fleetwood revenue driver 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 any form of review of the appropriateness of allowed revenue, should consider the entire SO entry capacity incentive scheme and not focus on a single entry point in a piecemeal way through the 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 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 would not be efficient and National Grid therefore continues to believe 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.

In summary, National Grid accepts the proposed changes to the NTS licence but continues to question whether it is appropriate to effectively review the outcome of the 2002-07 price control through the use of the IAE mechanism.