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*Promoting choice and value for
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Date: 08 February 2013

Dear Steve

Lead times for contractual delivery of Incremental Obligated Entry Capacity at the March 2013 Quarterly System Entry Capacity (QSEC) auction

In your letter of 11 January 2013 you sought our approval to extend the lead times to deliver incremental obligated entry capacity ("incremental capacity") at Milford Haven (MH) and Isle of Grain (IoG) purchased at the QSEC auction in March 2013.

We¹ have considered your arguments and decided, specifically on this occasion, to approve the extension of lead times for MH and IoG at the March 2013 QSEC auction. Our approval is based on you using the total existing permit balance to also defer the lead times. An outline of your request and the reasoning for our decision is described below.

Background

Special Condition C8D Part A paragraph 3(g) of National Grid Gas Transmission's (NGGT's) gas transporter licence states that the licensee may, with our consent, vary the lead times for delivery of incremental capacity from the default of 42 months. Any variation to the lead times for the delivery of incremental capacity is noted in the QSEC auction invitation letter; this letter is issued to stakeholders 28 days before the QSEC auction starts.

You asked us to approve the extension of lead times to 78 months for delivering incremental capacity at MH and IoG. We have assumed that you would utilise your total existing permit balance to defer the delivery of incremental capacity.

In your view, the extended lead times are necessary because network reinforcements required to provide incremental capacity at both entry points cannot be completed within the default lead time extended using the permit balance due to Planning Act (2008) consenting timescales. This creates the risk that if the lead times are not increased NGGT may have to buy back incremental capacity purchased at the March 2013 QSEC auction which cannot be delivered in the default lead time extended using the permit balance.

You also submitted two alternative solutions should we find the extension of lead times unacceptable. The alternative options were:

- NGGT exercises its discretion and only makes available quantities of incremental capacity that can be released within 42 months at MH and IoG; or

¹ The terms "Ofgem", "the Authority", "we" and "us" are used interchangeably in this document.

- if a successful bid for incremental capacity were received at MH or IoG, NGGT would ask us to direct it not to implement the proposal to release that capacity on the grounds it would not be economic or efficient².

Your submission of 11 January 2013 contained an annex listing the reinforcement projects and associated construction timescales necessary to deliver incremental capacity at both MH and IoG. This annex confirmed both entry points would require significant additional pipeline, compressor and other associated reinforcement should shippers purchase additional incremental capacity. The timescales associated with the construction of new pipelines and/or compressors at MH and IoG required a period of 78 months to construct. These timescales were based on your view of the anticipated time it would take to progress reinforcement work under the Planning Act (2008).

The submission also stated you had engaged with industry to understand the demand for new entry capacity at MH and IoG. In particular, you had issued an open letter to industry in December 2012 seeking views on the demand for additional capacity not previously disclosed to NGGT. You received no responses to this letter. You also indicated that discussions had taken place with stakeholders about the difficulty in constructing additional infrastructure at MH and IoG within the default lead time.

On 18 January 2013 representatives from Ofgem and NGGT held a teleconference to discuss the request in more detail. At that teleconference, we asked you to provide additional information on the possibility of substituting capacity, particularly from Dynevor Arms to MH, to meet demand for additional capacity at MH and IoG. We also discussed the potential scale of buyback costs if NGGT received capacity requests it could not deliver, and we requested further details of the discussions held between NGGT and stakeholders about additional capacity at MH and IoG.

You submitted this information on 23 January 2013. You confirmed that substituting capacity from Dynevor Arms to MH would not result in the reduction of network investment levels identified in your letter of 11 January. In this respect, you considered 78 months were still required to provide additional capacity at MH. You also set out that substituting capacity to IoG would result in an exchange rate of greater than 3:1 and, hence, would be ineligible under the Entry Capacity Substitution Methodology Statement.

You provided more information on the discussions held with [REDACTED] operators. According to your submission, you have delivered a consistent message to operators [REDACTED] that the default lead time for delivering incremental capacity is not sufficient to build significant levels of network investment. This has been incorporated into the planning decisions at both entry points.

Previous decision

Last year you submitted a similar proposal to extend incremental entry capacity lead times at MH and IoG by using more permits than were available to you. You sought an increase to the total permit volume in order to delay the delivery of incremental capacity to 72 months at both entry points. We rejected this proposal on the basis that you had not provided sufficient evidence to justify an extension to lead times and that insufficient notice had been given to shippers about the intention to extend the lead times.

Our views

After considering the evidence submitted we have decided to approve your request in this instance. In making this decision we have been mindful of the relevant objectives contained in the gas transporter licence and our statutory and wider duties.

² This would require the Authority to exercise its discretion under Special Condition C8D Part C paragraph 9(k)(ii) of NGGT's gas transporter licence

We consider that extending the lead times to deliver incremental entry capacity triggered in March 2013 at MH and IoG will provide consumers with protection against incurring significant buyback costs due to capacity signals being made which cannot be delivered within the default lead time extended using the permit balance.

In the 2011 and 2012 QSEC auctions you used the balance of permits available to extend incremental capacity lead times at MH to 69 and 66 months respectively. This sent a clear signal to shippers that you consider that the default lead time was not sufficient to construct the additional infrastructure necessary to deliver incremental capacity.

There is a lower volume of permits available in the TPCR4 rollover settlement for you to defer the release of incremental capacity at the 2013 QSEC auction. The total permit value in the rollover year is 1440 GWh, enough to defer the delivery of 475 GWh of incremental capacity at MH by three months. This creates a material risk NGGT may have to buy back capacity allocated to shippers that cannot be delivered in time. While we have designed a constraint management incentive appropriately to balance cost between you and shippers/end consumers ultimately there is a risk that a significant level of those buyback costs would be passed onto consumers.

Extending the lead times applicable at the March 2013 auction in these circumstances would make sure that incremental capacity available at MH and IoG has appropriate delivery lead times and, hence, the need for NGGT to incur buyback costs is avoided.

We note you have provided a list of reinforcement work required at MH and IoG to deliver incremental capacity. You estimated the construction of new pipelines and other related reinforcement work would require 78 months to complete work at both entry points. While we consider this is a conservative view of the length of time it will take to progress reinforcement work within the Planning Act (2008) framework, the level of detail provided is much improved on last year's submission allowing us to make an informed decision.

We would expect that as construction projects are progressed through the Planning Act regime you will be able to produce more refined and less conservative consenting timescales.

We also note that you are engaging with shippers and other stakeholders about the demand for incremental capacity, amongst other things. While there is no apparent incentive at present on shippers to indicate their capacity requirements in advance of the auction we understand that you have not received any response to your open letter of 7 December 2012. That letter gave shippers the opportunity to inform you where additional capacity might be signalled, including at MH and IoG. You also stated that operators at MH and IoG had been told consistently that the default lead time is not sufficient to build additional network infrastructure.

Together with the the use of permits in previous auctions to delay incremental capacity delivery, shippers and other stakeholders should be aware of your concerns that the default lead time is not sufficient to deliver incremental entry capacity at MH and IoG which may be triggered in March 2013.

The alternative options

Our decision to approve the extension of lead times negates the two alternative solutions you suggested. However, we consider it is useful to give you our views on them.

The first option was to allow you to exercise your discretion and limit the availability of incremental capacity at MH and IoG to quantities that can be delivered in time. This would result in much lower volumes of incremental capacity being made available at both entry points.

We were not in favour of this option. A principle of the commercial regime is that you must make all available capacity open to the market for purchase. In our view, withholding capacity in this instance could send inappropriate signals to shippers and other stakeholders about the future availability of capacity. In this regard, we considered that extending the lead times would provide a more precise and transparent signal to shippers about the availability of incremental capacity at MH and IoG.

We were also concerned as to whether shippers and other stakeholders would have been notified far enough in advance that incremental capacity would be restricted at MH and IoG.

The second option was for you to ask us to direct that you should not release the incremental capacity purchased at MH and IoG that cannot be delivered in time. In our view, this would have been an inappropriate course of action in such circumstances.

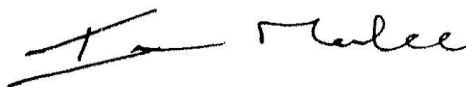
It is incumbent on you to put in place and manage capacity allocation mechanisms that provide baseline and incremental capacity to shippers. It is not our role under normal circumstances to restrict capacity successfully allocated to shippers using approved allocation methodologies. You should use your knowledge of the market and take early and appropriate action to resolve any capacity allocation issues. It should not rely on us to refuse the release of capacity allocation in situations where the issues were foreseeable.

Our decision

Following consideration of the documentation provided and having regard to its principal objective and statutory duties, and for the reasons set out above, the Authority has decided, pursuant to Special Condition C8D, to approve lead times extended beyond those available using the total existing permit allowance to 78 months for delivery of incremental entry capacity at MH and IoG entry points.

Can you please contact James Thomson on 0141 331 6012 or james.thomson@ofgem.gov.uk should you have any questions about this decision.

Yours sincerely



Ian Marlee

Senior Partner, Smarter Grid and Governance: Transmission

Signed on behalf of the Authority and authorised for that purpose