



The Company Secretary
National Grid Gas Plc
1-3 Strand
London
WC2N 5EH

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

Direct Dial: 020 7901 7159
Email: Andrew.Burgess@ofgem.gov.uk

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Dear Company Secretary

Continuation of cross-subsidy arrangements for the Statutory Independent Undertakings

This letter explains the background, reasons and effects of a direction from us¹ to National Grid Gas plc ("NGG") to give effect to a licence condition in relation to the Statutory Independent Undertakings ("SIUs"). These arrangements are where NGG socialises the costs of providing gas to off-grid networks owned by Scotland Gas Networks plc ("SGN") and Wales & West Utilities Limited ("WWU").

The direction gives effect to Parts B to E of Special Condition 11F (Gas conveyed to Independent Systems) ("SpC 11F") of NGG's Gas Transporter Licence from 1 April 2013. We have issued this direction as a consequence of a direction to NGG and others issued by the Secretary of State (DECC) on 21 March 2013 relating to the continuation of the cross-subsidy arrangements for SIUs.

Under the current arrangements for SIUs, NGG pays the Relevant Shipper(s)², SGN and WWU, the additional amounts for serving consumers under Special Condition C26³ (Gas Conveyed to Independent Systems) ("SpC C26") from its national transmission system ("NTS") charges paid by its customers. In effect, this sets up a cross-subsidy where ultimately all gas consumers subsidise the cost of providing gas to consumers on SGN and WWU's Independent Systems⁴. The cross-subsidy arrangements were initially put in place for the period from 1 April 2008 to 31 March 2013.

SpC 11F contains the arrangements for facilitating the continuation of the cross-subsidy for SIUs from 1 April 2013. In particular, SpC 11F requires NGG to recover amounts from gas shippers and then pay those amounts to:

1. the Relevant Shipper for the Bulk Price Differential⁵; and

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

² A Relevant Shipper is a gas shipper that has arrangements with SGN or WWU under which LNG or LPG is to be conveyed to consumers.

³ SpC 11F will replace SpC C26 from 1 April 2013 as part of the RIIO-T1 licence changes.

⁴ An Independent System is a pipeline system in SGN's and WWU's licensed areas that is not connected by pipelines to the main pipeline system.

⁵ The Bulk Price Differential is the volume of LPG conveyed to consumers multiplied by the difference between the reasonable estimate of the actual delivered price of the LPG supplied to consumers and the average price of gas consisting principally of methane supplied to large industrial consumers in GB.

2. SGN and WWU for the additional costs of conveying gas to consumers within their Independent Systems.

Paragraph 5 of SpC 11F also contains a provision whereby we may issue a direction to give effect to Parts B to E of SpC 11F following a direction issued by the Secretary of State for the continuation of the cross-subsidy arrangements for SIUs. The Secretary of State has now issued such a direction. We have consequently decided to issue a direction pursuant to paragraph 5 of SpC 11F to give effect to Parts B to E of SpC 11F from 1 April 2013.

This letter constitutes notice pursuant to section 38A of the Gas Act 1986 of the reasons for our decision.

Yours faithfully,

Andrew Burgess
Associate Partner, Transmission and Distribution Policy

Direction issued to National Grid Gas plc by the Gas and Electricity Markets Authority pursuant to paragraph 5 Special Condition 11F (Gas Conveyed to Independent Systems) ("SpC 11F") of its Gas Transporter Licence giving effect to Parts B to E of SpC 11F

1. This Direction is issued by the Gas and Electricity Markets Authority (the "Authority") pursuant to paragraph 5 of SpC 11F of the Gas Transporter Licence in respect of the National Transmission System (the "Licence") treated as granted under section 7 of the Gas Act 1986 (the "Act") to National Grid Gas plc (the "Licensee").
2. Parts B to E of SpC 11F of the Licence provides that the Licensee must pay a Relevant Shipper⁶, Scotland Gas Networks plc and Wales & West Utilities Limited in respect of the additional costs of serving customers connected to Independent Systems⁷.
3. Paragraph 4 of SpC 11F provides that the Licensee's obligations under SpC 11F (Parts B to E) apply only from the date on which the Secretary of State has issued a direction requiring the Licensee to do all such things under that condition to secure the cross-subsidy arrangements that were in force under the Licence on 31 March 2013.
4. Paragraph 5 of SpC 11F provides that the Authority may direct SpC 11F (Parts B to E) to come into effect on or at any time after the direction has been issued by the Secretary of State.
5. The Secretary of State issued a direction on 21 March 2013 and the Authority subsequently directs pursuant to paragraph 5 of SpC 11F of the Licence that Special Condition 11F (Parts B to E) shall have effect.
6. The Direction shall remain in force until revoked or varied by the Authority.
7. This Direction shall have effect from 1 April 2013.

Andrew Burgess
Associate Partner, Transmission and Distribution Policy

For and on behalf of the Authority
28 March 2013

⁶ As defined in SpC 11F of the Licence.

⁷ As defined in Standard Special Condition A3 of the Licence.