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for energy consumers

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Dear Helen

Lead times for the contractual delivery of Incremental Obligated Entry Capacity at the March 2014 Quarterly System Entry Capacity (QSEC) auction

In your letter of 13 November 2013 (updated on 16 December 2013) you sought our approval to extend the lead times to deliver incremental obligated entry capacity ("incremental capacity") at Milford Haven and Isle of Grain purchased at the QSEC auction in March 2014.

We¹ have considered your arguments and decided, on this occasion, to approve the extension of lead times for Milford Haven and Isle of Grain at the March 2014 QSEC auction. However, we emphasise that this approval should not be taken as a precedent for future requests to extend the lead times to deliver incremental capacity, in the absence of industry agreed processes, procedures and mechanisms to deal with extended delivery times. Our approval is based on you also using the total existing permit balance for 2013-14 to defer the lead times. An outline of your request and the reasoning for our decision is described below.

Background

Special Condition 2D paragraphs 2D.11, 2D.12 and 2D.13 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 Milford Haven and Isle of Grain. As indicated in your letter, we have assumed that you would use your total existing permit balance to defer the delivery of incremental capacity at Milford Haven.

You have stated that 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) consent timescales and the quantity and complexity of the investment projects required. This creates the risk that if the lead times are not increased, you may have to buy

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

back incremental capacity purchased at the March 2014 QSEC auction which cannot be delivered in the default lead time extended using the permit balance.

You also submitted an alternative solution, should we find the extension of lead times unacceptable. This is that if a successful bid for incremental capacity were received at Milford Haven or Isle of Grain, you would ask us to direct you not to implement the proposal to release that capacity on the grounds it would not be economic or efficient².

Your submission of 13 November 2013 contained an appendix listing the reinforcement projects and associated construction timescales necessary to deliver incremental capacity at both Milford Haven and Isle of Grain. This annex confirmed both entry points would require significant additional pipeline, compressor and other associated reinforcement should shippers purchase additional incremental capacity. The time required to construct new pipelines and/or compressors at Milford Haven and Isle of Grain is estimated at 78 months. These timescales were based on your view of the time it would take to progress reinforcement work under the Planning Act (2008).

Your letter indicated that alternatives to investment such as Entry Capacity Substitution and contractual solutions are not feasible or appropriate, given the potential quantities required, for IOEC at Milford Haven and Isle of Grain due to the lack of suitable donor ASEPs and the feasibility and anticipated costs of contractual arrangements. You provided details on why these alternatives should be discounted in an appendix.

The submission also stated you had engaged with industry to understand the demand for new entry capacity at Milford Haven and Isle of Grain. In particular, you had issued an open letter to industry in August 2013 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 Milford Haven and Isle of Grain within the default lead time.

Discussions

On 03 December 2013 representatives from Ofgem and NGGT met to discuss the request in more detail. At that meeting, we asked you to provide clarification on the length of extension required at Milford Haven and to provide further detail on the potential scale of buyback costs if NGGT received capacity requests it could not deliver. We requested further details of the discussions held between NGGT and stakeholders about additional capacity at Milford Haven and Isle of Grain, in particular details of any further written communications, and asked you to consider advising the industry of your request to us to extend lead times.

You submitted an updated letter clarifying the extension required at Milford Haven and further details of on the potential scale of buyback costs on 16 December 2013.

We note that you have incorporated information regarding the lead time for providing NTS Entry (and Exit Capacity) across different geographical zones as an indicative guide for customers in your Gas Ten Year Statement (GTYS) published 20 December 2013. We welcome this enhancement to the document. We also welcome your decision to advise the industry that you had requested an extension to lead times via the statement issued by the Joint Office of Gas Transporters on 24 December 2013.

According to your submission, you have delivered a consistent message to operators and other key players that the default lead time for delivering incremental capacity is not sufficient to build significant levels of network investment.

Previous decisions

² This would require the Authority to exercise its discretion under Special Condition 5F paragraph 5F.9 of NGGT's gas transporter licence

Last year, in the March 2013 QSEC, you submitted a similar proposal to extend incremental entry capacity lead times at Milford Haven and Isle of Grain that was approved. We had previously rejected the March 2012 QSEC 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. We consider that extending the lead times to deliver incremental entry capacity triggered in March 2014 at Milford Haven and Isle of Grain 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 Milford Haven to 69 and 66 months respectively. Last year the lower volume of permits allowed only a three month extension at Milford Haven, and we allowed the lead times to be extended. This has sent a signal to shippers that you consider that the default lead time was not sufficient to construct the additional infrastructure necessary to deliver incremental capacity.

Although there is a higher level of permits available this year compared to last, this only allows deferral of the delivery of 475 GWh of incremental capacity at Milford Haven by eight months. This creates a material risk that 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 2014 auction in these circumstances would make sure that incremental capacity available at Milford Haven and Isle of Grain has appropriate delivery lead times and, hence, the risk of NGGT incurring buyback costs is reduced.

We note that you have provided a list of reinforcement work required at Milford Haven and Isle of Grain to deliver incremental capacity. You estimated that 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 cautious 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 sufficient to allow us to make an informed decision on your request.

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

We also note that you are engaging with shippers and other stakeholders about the demand for incremental capacity, amongst other things. In particular we have noted the information relating to lead times for providing capacity that you have incorporated in the most recent publication of your GTYS and the notification by the Joint Office that you have requested an extension to lead times. 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 1 August 2013. That letter gave shippers the opportunity to inform you where additional capacity might be signalled, including at Milford Haven and Isle of Grain. You also stated that operators and key players at Milford Haven and Isle of Grain have been told consistently that in your view, the default lead time is not sufficient to build additional network infrastructure. We have also considered whether to carry out a consultation with stakeholders. We would normally consult if we considered the issues raised by you called for additional information from industry to allow us to reach a decision. On balance we considered that you have presented sufficient information and that the usefulness of a consultation would be limited.

Together with the use of permits in previous auctions to delay incremental capacity delivery and our decision last year to allow lead times to be extended, shippers and other stakeholders should be aware of your concerns that the default lead time is not sufficient to deliver incremental entry capacity at Milford Haven and Isle of Grain which may be triggered in March 2014.

We emphasise to you that our approval is not a precedent that we will automatically agree future requests to extend the lead times to deliver incremental capacity. In addition, we had hoped that appropriate processes, procedures and mechanisms would already be in place that would take account of the planning and consultation work now required owing to the introduction of The Planning Act 2008, and other associated developments. We believe that it is now imperative that the industry develop and agree appropriate arrangements and it is incumbent on you to facilitate this development. If a similar decision is required in the future, it will be influenced by the progress made on this issue.

The alternative options

Our decision to approve the extension of lead times removes the need for the alternative solution you suggested. We rejected this alternative when you proposed it last year. However, we consider it is useful to repeat to you our views on it.

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

You are required 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. NGGT 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, we have decided, pursuant to Special Conditions 2D, to approve lead times extended beyond those available using the total existing permit allowance to 78 months for delivery of incremental entry capacity at Milford Haven and Isle of Grain entry points.

This letter constitutes notice pursuant to section 38A of the Gas Act 1986 of our reasons for our decision to consent to the extension of lead times for the contractual delivery of Incremental Obligated Entry Capacity. Please contact David Reilly on 0203 263 9648 or david.reilly@ofgem.gov.uk should you have any questions about this decision.

Yours sincerely

Andrew Burgess

Associate Partner, Transmission and Distribution Policy

Signed on behalf of the Authority and authorised for that purpose