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Gas transmission capacity - proposal to terminate Permit Arrangements and adjust the revenue earned from Permit Arrangements for the period 1 April 2013 – 31 March 2015

Dear David,

Thank you for the opportunity to respond to your consultation on the proposed policy changes relating to the use of Permits to vary lead times for the provision of incremental gas transmission capacity. This response is made on behalf of National Grid Gas' Transmission business (NGG).

Our role as the owner and operator of the GB Gas Transmission System is to ensure the safe, economic and efficient development, operation and maintenance of the National Transmission System.

During the development of the Planning and Advanced Reservation of Capacity Agreement (PARCA) arrangements National Grid proposed that the approval and implementation of the arrangements should mean that Permits would no longer be required. We therefore agree with Ofgem that this should be the case.

We note that the timing of this consultation means that any adjustment to the revenue earned from the Permit Arrangements could occur after the current Permit Arrangements have ceased (1st April 2015). Each of the proposed options in Ofgem's consultation adjusts the financial value of a previously directed regulation i.e. the Permit Arrangements. We are disappointed in the process followed by Ofgem in this matter. In Ofgem's 17th March 2014 consultation to extend the Permit Arrangements to 31st of March 2015, and subsequently in your letter of 28th April 2014 that announced your decision to extend those arrangements, Ofgem said:

"If and when new commercial arrangements are introduced we will consider what an appropriate and fair treatment of NGG's Permit allowance is".

When the Permit Arrangements were extended to cover formula year 2014/15, it was clear that PARCAs could come into effect during 2014/15. It continues to be our view that the consultation to extend the Permit Arrangements should have been clear how the permit value was derived given the nature of the permit scheme and how and why the value of the Permit Arrangements would be adjusted if PARCAs were in place within the formula year.

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This would have provided certainty and clarity of what ex-post adjustments to the scheme would be required should that risk be reduced. We feel in this matter that Ofgem have fallen short of providing National Grid with up front regulatory certainty.

Although we are disappointed in the process followed by Ofgem, we do agree that a balanced and pragmatic approach to reduce the financial value of the current Permit Arrangements that reflects the reduced risk due to the introduction of PARCAs should be considered. However, we do not agree it is appropriate or fair to reduce the financial value of the arrangements based upon historic performance as detailed under the third option in your consultation. National Grid has taken responsibility to manage the risks we faced, acting and adapting to new information throughout the duration of the permit scheme. National Grid believes it is poor regulatory practice for Ofgem to adjust the value of an incentive scheme according to how a network company acted in response to that scheme and with the full benefit of hindsight. Please find below our detailed response to your consultation.

Timing

We agree with Ofgem's view that National Grid would not deliberately seek to delay the implementation of the PARCA arrangements. Throughout the development of the PARCA proposals we have sought to ensure the package of fully developed proposed changes are submitted to Ofgem at the earliest opportunity. We continue to be of the view that the package of PARCA changes should be implemented as soon as practically possible.

We welcome Ofgem's recent approval of UNC Modification 0465v and the direction of the associated PARCA licence changes, both of which will be effective ahead of the March 15 QSEC. Your consultation states that:

"If PARCAs are introduced before the March 15 QSEC auction, we intend to amend the revenue earned from Permits for 1 April 2013 – 31 March 2015"

The required changes to the methodology statements (amended for the purpose of the PARCA arrangements) are, at the time of writing, subject to industry consultation and Ofgem approval. As a result of recent industry feedback we extended the consultation period for the methodology statements to the 16th of January 2015 which means we will submit the methodology statements to Ofgem for approval no later than 31st of January 2015. This reduces the likelihood of the methodology statements being approved by Ofgem ahead of the March 15 QSEC invitation letter being issued in mid February 15. In the absence of an Ofgem approval ahead of this invitation letter being issued, we intend to apply the spirit of the PARCA arrangements to the March 15 QSEC. This means that we would not make Funded Incremental Obligated Entry Capacity available through the March 15 QSEC and hence there would be no requirement to play permits.

National Grid requests confirmation from Ofgem, ahead of the March 15 QSEC invitation letter being issued, that Ofgem agree this course of action to be appropriate. In the absence of such confirmation then National Grid will need the ability to play permits for the March 15 QSEC and as such would agree with your proposed consultation approach that the current Permit Arrangements and allowances should remain in place under this scenario.

Adjusting the revenue earned from Permit Arrangements for the period 1 April 2013 – 31 March 2015

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We support the Ofgem view detailed below that any adjustment to the value of the Permit Arrangements should be reflective of the reduced forward risk directly associated with the introduction of the PARCAs:

"We think it is right to reflect the reduction in NGGT's prospective risk; that is, the fact that once PARCAs are implemented, incremental capacity requests can be managed without the need for Permits"

Proposed Options

1. Time related adjustment

We agree that the simplicity of a time related adjustment has merit in what is a complex area and that the risk of an incremental capacity signal requiring Permits is not necessarily uniform across the formula year. Whilst that risk may not be uniform, we do consider it to be ever present as:

- Incremental Entry Capacity can be signalled all year round through either the March QSEC or ad-hoc QSECs and;
- Incremental Exit Capacity can be signalled all year round through the July application window, the ad-hoc application window and through Advanced Reservation of Capacity Agreements (ARCAs).

We note that one of the time related adjustment options is applied to the full permit value of £32.39m. We believe that any adjustment options should only consider an adjustment to the additional 2014/15 Permit Allowance given that it is only the 2014/15 balance of risk that could be impacted by the introduction of PARCAs. As such we do not consider that a time related adjustment to the full Permit value of £32.39m applicable to 2013/14 and 2014/15 to be a valid or acceptable approach.

We also note that this option uses July 2014 as the starting point to derive the time related adjustment. Whilst the extension to the Permit scheme was not effective until July 2014, the scheme is applicable to the entire formula year. We therefore believe that April 2014 should be used as the correct starting point to calculate the time related adjustment.

Given the above and the fact that the PARCA arrangements are intended to be effective 10 months into the current financial year (i.e. from February 2015), we consider the following option, that reduces the value of the additional 2014/15 allowance by 2/12ths, is a logical and correct application of the time related adjustment. . This would equate to an adjustment of £2.23m and a revised permit scheme value of £30.16m:

Effective date of PARCA arrangements	Apr-14	May-14	Jun-14	Jul-14	Aug-14	Sep-14	Oct-14	Nov-14	Dec-14	Jan-15	Feb-15
adjustment - £m's	13.39	12.27	11.16	10.04	8.93	7.81	6.70	5.58	4.46	3.35	2.23

It should be noted that, although we believe our alternative proposed option is the correct application of a time related adjustment we are conscious that this would result in a smaller financial adjustment than Ofgem proposed under this option; our preferred adjustment option

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is 2b from your consultation (which would be an adjustment of £3.96m) and our rationale underpinning this view is detailed below.

2. Adjustment related to whether Permits were allocated for entry or exit capacity

We agree that the Permit allowance is intended to be a total envelope and support splitting the entry and exit risk according to the subjective assessment Ofgem made at that time. This would lower the revenue earned from Permit Arrangements by £3.96m. The Permit allowance can and is used flexibly at those locations that would otherwise risk delayed delivery of incremental capacity and the potentially associated industry costs. Given the subjective nature of the Permit scheme, we believe that option 2b, which is based upon Ofgem's subjective assessment of their historic forecast, is the fairest and most appropriate representation of the reduced risk directly resulting from the potential introduction of the PARCA arrangements ahead of the March '15 QSEC auction.

We do not consider Ofgem's view that the projected data provided by NGG "has not proven to be accurate thus far" is a fair conclusion or indeed possible. The ex-ante nature and the mechanics of the Permit Arrangements require a pragmatic view of risk to derive an appropriate quantity and value of Permits and how, when and where to play and potentially utilise the finite quantity of available Permits. For example, the projected data we provided to Ofgem did not incorporate all potential incremental signals we believe are possible as the risk of all potential signals being received within similar timescales is less than that of individual signals being provided at any time, hence we scaled down our projected data accordingly. Additionally, we do not know what signals may have been generated had we not historically "played" Permits or managed our customers' needs through, for example, the use of PCAs.

We do not consider option 2a which proposes an arbitrary 50:50 split of the additional year 2 Permit value is a fair, reasonable or appropriate reflection of the reduced risk attributable to the introduction of the PARCA arrangements.

3. Permits committed for use

This option reduces the value of the Permit scheme based on a historic snapshot of where we "played" Permits for the July '14 and July '13 Enduring NTS Exit (Flat) capacity windows. The Permit scheme is intended to encourage balanced decisions and as such we carefully consider where, when and how to play Permits. We do not believe that using a historic snapshot is representative of the actual Incremental Entry and Exit Capacity risk we have, and continue to, manage.

We also consider that this option is not in keeping with the intention of the Permit Arrangements. Those arrangements remunerate based on an ex ante cash out value for each permit remaining at the end of the relevant period and do not adjust the original value of the arrangements based on where we have or haven't played permits. Additionally this option does not represent a subjective assessment of the forward reduced risk directly attributable to the introduction of PARCAs ahead of the March 15 QSEC. As such, we do not believe this option should be further considered.

Question 1: What is your preferred approach to adjust the revenue earned from Permits? If you have an alternative, please explain how it works.

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Of the approaches detailed, we consider that Option 2b is the best representation of Ofgem's aim that the revenue adjustment should reflect the reduced forward risk resulting directly from the introduction of the PARCA arrangements. As such it is our view that this is the most suitable of the proposed options.

As aforementioned we have also provided an alternative time related adjustment option as it is our view that the time related options from your consultation incorrectly pro-rate from July 2014. In addition, one of the variants also applies the pro-ration to the total permit allowance even though it is only the 2014/15 balance of risk that is impacted by the implementation of the PARCA arrangements. Our alternative pro-rates the 2014/15 additional allowance of £13.39m from April 2014 which results in a revenue adjustment of £2.23m (a reduction to the additional 2014/15 allowance by 2/12ths):

Effective date of PARCA arrangements	Apr-14	May-14	Jun-14	Jul-14	Aug-14	Sep-14	Oct-14	Nov-14	Dec-14	Jan-15	Feb-15
adjustment - £m's	13.39	12.27	11.16	10.04	8.93	7.81	6.70	5.58	4.46	3.35	2.23

Question 2: What are your views on our Licence change proposals?

Our preference would have been for the current Permit licence text to have included an adjustment mechanism in the event of PARCA arrangements being introduced ahead of the March 15 QSEC. We are therefore disappointed that a consultation to retrospectively adjust the value of the permit scheme is necessary.

Notwithstanding the above, we do support an adjustment to the value of the permit scheme, however we do not agree with the proposed licence drafting to enact this adjustment. The licence drafting largely deletes the current Permit licence text and replaces it with a modified value for the Permit Arrangements. This consultation is seeking views on adjusting the value of the scheme and is not proposing any adjustment to the mechanics of the scheme or the number of Permits available to utilise. As such we consider the licence drafting should simply change the values of £13.39m and £32,390,000 in paragraph 2D.1 and £32,390,000 in paragraph 2D.23 to the revised values. This would also ensure that any Permits used between now and the potential licence change coming into effect would be accounted for correctly.

Should Ofgem wish to discuss any of the points raised in this response, please contact myself or Mike Wassell at mike.wassell@nationalgrid.com (01926 654167).

Yours sincerely

HCampbell.

Helen Campbell