BUY BACK RISK

1) The premise of this question is incorrect. Ofgem has never had a policy of "maintaining consistent levels of buy back risk from one control to another". Ofgem's policy at this price control, as at others, is that the level of non-diversifiable risk to which a regulated business is exposed and the costs of capital allowed to that company should be mutually consistent. This does not necessarily mean that the level of risk in any one aspect of the incentive regime should be the same from one control to the next. The network analysis carried out determined the current baselines. The assumptions used in this modelling differed from the assumptions underlying the mode for the previous price control period. Different modelling assumptions lead to different outputs.

2) It is not clear that the level of buyback risk in the period April 2007 – March 2012 is significantly different than that in the period April 2002 – March 2007. For instance if the potential flow patterns of gas are less certain over the later period (for instance resulting from the coming on stream of various new import facilities in different parts of the country) then a given set of baselines would be more risky. Ofgem undertook its analysis of network capability and has set the baselines that seem to it consistent (when taken with all the incentive package) with the cost of capital provided to NGG. In addition Ofgem notes that it has increased NGG's exposure to buyback costs between the two period.
    a. NA
    b. Ofgem does not 'police' the level of buyback risk in the way suggested in this question. NGG is given a set of incentives to which it responds. Those incentives imply a level of risk which NGG will no doubt try to manage. However Ofgem will have powers of veto and regulation over NGG's capacity transfer methodology which will have a bearing on these matter. Shippers are urged to engage actively with NGG on the development of this methodology.

3) If capacity beyond the baselines is desired at an entry point then the shippers will have several options to get it. They can purchase and create new incremental capacity (longer term only), purchase unsold capacity which they will transfer, or arrange to purchase the capacity from another shipper who does not want it. Ofgem is unable to comment on the specific proposals UNC133 (which I understand is what is intended by the reference to "NG's proposal" in this question) on which it will have to make a decision in the future.

4) Ofgem notes that since buyback costs not borne by NGG are passed through to shippers it is likely that these costs will ultimately be passed through to suppliers (and hence consumers). Ofgem therefore considers that the buy back risks *to shippers* would be minimal.
    a. Ofgem's views on Mod 129 were set out in the decision letter. Although urgency was granted on the grounds of the expected magnitude of buyback risk (expected cost to a code party being a criterion for granting urgency) the Modification Proposal was accepted on other grounds (the relevant code objectives). Ofgem considers that had 129 not been implemented shippers could, by purchasing capacity, have put NGG in a position where it sold the maximum of the current baseline and the baselines proposed in the TPCR at each entry point. It is less likely the network could accommodate this and therefore NGG would need to buyback capacity. The buyback costs in such a situation could be significant

    a. but would obviously depend on the prices shippers would be willing to accept.
    b. Ofgem has not assessed the level of buyback risk in this hypothetical circumstance.

5) No
6) Buyback of capacity remains, as it is currently, an obligation on the licensee if it is unable to physical deliver capacity it has sold. How the licensee manages that risk, in accordance with its licence and other obligations, is a matter for the licensee. The intention behind the buyback system is unchanged.
7) Ofgem notes that it has changed aspects of NGG's incentive mechanism as part of the TPCR but rejects the premise of this question as it has not *forced* a change to the UK supply pattern.
8) The 5% Flow Margin was one of the assumptions in the modelling.
9) It is always possible to reopen price controls although Ofgem would be strongly disinclined to do so. NGG secured agreement from Ofgem that the parameters of the operational buyback incentive scheme will be reviewed and possibly reset after two years. Ofgem is currently considering the best way to give effect this commitment.
10) The licence obligations, including the capacity transfer obligation, will be introduced with effect from 1 April 2007.

NON-DISCRIMINATION

1) Ofgem allocated the reductions in baselines in a given zone in a manner intended to be non-discriminatory subject to the constraint that baseline obligations could not drop below the capacity already sold. Ofgem did this by adjusting the numbers from its September document downwards in a zone in a way related to the size of the entry point in question.

2) Where there was a reduction in the baselines in a zone relative to the update proposal numbers the reduction was of unsold capacity. As Ofgem has consulted several times in the process of developing its approach to gas entry modelling it was not considered that further consultation would have been required. Further consultation would have significantly delayed the implementation of the TPCR.

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BETTER REGULATION PRACTICE / REGULATORY STABILITY

1) To the extent that any such commitment was given at the previous price control round (it is noted that no documentary evidence to this effect was presented as part of the TPCR process) this was changed by the announcement in the TPCR process (on which Ofgem consulted widely) that Ofgem was minded to change from using a theoretical maximum physical model to a practical maximum physical model.

2) Ongoing discussions with NGG provided support for NGG's view of common zonal constraints not accounted for in the modelling underlying Ofgem's updated proposals. In addition the update proposals indicated capacity release obligations in 2008/09. The final proposals indicated them for 1 April 2007, so at any entry point wherein there was a signal for incremental capacity between those periods there would be a difference.

3) Ofgem is not proposing to change the rules for the release of incremental capacity (i.e. capacity above the baselines), although the detailed rules are the responsibility of NGG not of Ofgem. NGG's substitution obligation

should reduce the ability of NGG to get money for releasing incremental capacity without the need to build.

4) The baselines will be introduced by means of a notice under section 23 of the Gas Act. This is a statutory consultation and Ofgem will given due consideration to any representations made.

5) I am unable to provide a complete answer. However, although it was not part of a price control review, Ofgem did make various changes to the licence condition splitting out the metering price controls as part of the s23 process. Fully researching this point would require a significant level of effort on Ofgem's part and has not been undertaken. Copies of all s23 notices and subsequent licence modifications are available from Ofgem's library and public register and anyone interested in researching this point should contact library@ofgem.gov.uk to arrange for an appointment to view the relevant materials.

METHODOLOGY

1) Ofgem signalled early in the price control process that it had concerns about the combination of sterilised capacity and the zero reserve price essentially leading to a situation whereby shippers were able to pick up capacity in the short term without providing any signal as to the value of that capacity. This was one of the main reasons that Ofgem proposed introducing a capacity transfer mechanism. It is not clear to Ofgem how shippers would have reacted in the last auction had they anticipated changes of baselines and how this would have differed from how they acted when they did anticipate the introduction of capacity transfer.

2) NGG has indicated concerns about the confidentiality of some of the information contained in the spreadsheet that was used to perform these calculations and has therefore asked the Ofgem not share it with the industry. Ofgem is working to produce a version of the spreadsheet which addresses the issues underlying these questions but without the commercially sensitive elements. Given the obvious priority that must be given to the licence drafting work Ofgem is unable to make a commitment to a timetable for providing this model.

3) I do not understand the question. The baselines in final proposals were derived from a modelling of network capability.
4) Physical flows from the 10YS were the starting point of the analysis but actual outturn physical flows were not modelled.

5) As set out in the TPCR documents the 10YS scenarios were used as the basis of the modelling carried out.

6) No. It is worth noting however that with a transfer market there is likely to be less need to build in artificially high baselines at each entry point.

BP submitted questions

1) Both Grain and Bacton capacity were reduced relative to the update proposals. The reduction of capacity at Grain quickly hit the constraint of not reducing capacity below the level already sold. If these entry points are genuinely supplying the same demand basin (assuming I have understood correctly what is meant by this term) it seems likely that capacity is relatively easily substitutable between the two entry points.

2) Capacity was reduced (relative to the update proposals) in those zones where there was reason to consider the zone could not accommodate all the capacity.

3) Ofgem took into account capacity that has been sold in all auctions (not just LTSEC auctions).

4) It is for NGG to develop a methodology for capacity transfers. Ofgem will respond to that methodology. Ofgem does not consider it impossible that only within zone transfers will occur but does not consider that there is a strong *a priori* reason to believe that this would be the case and therefore would need to be convinced on the point. For the avoidance of doubt Ofgem has not yet received the evidence to convince it on this point.

5) The current price control used 90% of theoretical maximum physical capacity. The new price control uses a practical maximum physical methodology. Different modelling assumptions give different results.

6) NGG's *exposure* to buyback risk has been increased. NGG's overall level of risk is consistent with their cost of capital.

SSE Submitted questions

1) The published baselines are the capacity release obligations as at 1 April 2007. The permanent obligated incremental capacity release at Hornsea takes place after 1 April 2007 and so is not included in this baseline.