

Mr Julian Majdanski

Joint Office of Gas Transporters
Ground Floor Red
51 Homer Road
Solihull
B91 3QJ

Martin Watson
Gas Charging and Access
Development Manager
Commercial
UK Transmission
National Grid

martin.watson@uk.ngrid.com
Direct tel +44 (0)1926 655023
Direct fax +44 (0)1926 653122
Mobile +44 (0)7795 666243

www.nationalgrid.com

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UNC Modification Proposal 0150 and 150A

Transitional Arrangements for Entry Capacity Transfers to Sold Out ASEPs

Dear Julian,

Thank you for your invitation seeking representation with respect to the above Modification Proposals.

Summary

National Grid NTS supports the implementation of Modification Proposal 0150. Our original comments as part of this proposal are re-iterated in the appendix.

National Grid does not support implementation of Modification Proposal 150A. For the following key reasons:

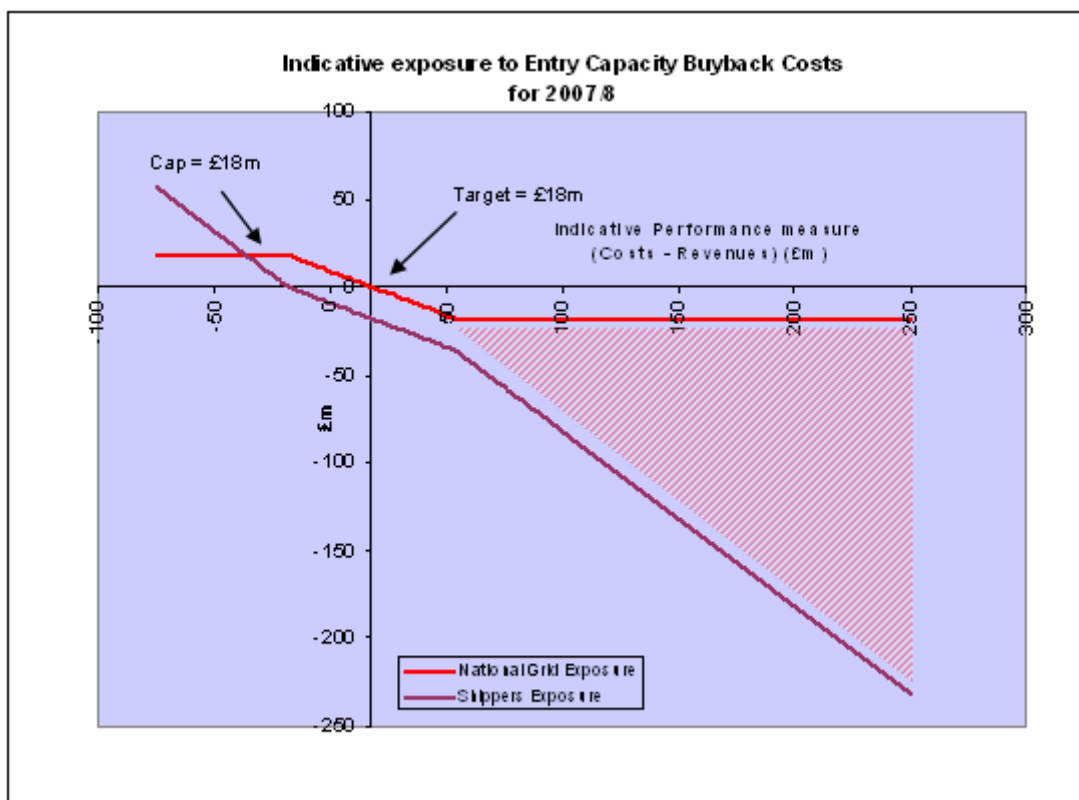
- **Specification of a 1:1 exchange rate up to the theoretical nodal maximum for within zone transfers with no consideration of potential costs, exposing Users to unlimited buy back risks**
- User specification of zones
- Limiting transfers to within zone
- Wholesale changes to the AMSEC and RMSEC processes
- Incorporation of an additional round in the 2007 AMSEC auction
- Timeline for implementation

In addition we would like to highlight that the proposal goes much further than the original Modification Proposal, by changing the allocation rules of the AMSEC and RMSEC auctions. We do not consider this appropriate under Urgent Modification timescales and with no prior industry consultation.

Reasons for not supporting Mod 0150A

Specification of a 1:1 exchange rate up to the theoretical nodal maximum for within zone transfers with no consideration of potential costs, exposing Users to unlimited buy back risks

The Modification proposal is counter to both Ofgem's final Proposals and the proposed Licence Condition to enact them, as it does not take into account the expected costs resulting from undertaking a transfer. The impact of this could be unlimited exposure to buy back costs for Users. The diagram below shows National Grid NTS understanding of how the buy back incentive currently proposed as part of Final Proposals would operate. Although the maximum exposure for National Grid NTS to buy back costs is set at -£18m (as determined by the collar of the scheme), there is no such limit for Users. Therefore as the proposal does not take any account of the possible increased risk of buy backs it is likely that users will be exposed to greater buy back costs. In addition the contractual risk for National Grid NTS will increase with the potential for higher buy back costs. Therefore National Grid NTS disagrees with the Proposer's assertion that contractual risk of each Transporter and User will not be affected.



It is also important to note that any increase in buy back actions will affect all Users with firm entry rights in an equal manner. Therefore Users who have purchased capacity in long term auctions could be faced with the increased possibility of being constrained-off as well as higher system costs. These Users are those who have given early signals which allow optimisation of investment and operation of the system.

National Grid NTS would also like to point out, as has been stated at several Transmission workstream meetings, that the nodal maximum is the theoretical physical capability of the local

infrastructure associated with the particular ASEP and that this level of physical capability can only be delivered where there are the most favourable supply and demand patterns (optimal demand and no competing flows). These favourable supply and demand patterns are not limited to within zone interactions, therefore if an assumption is made that capacity can be transferred on a 1:1 basis and this is done without taking buy back risk into account, Users could find themselves exposed to unlimited buy back costs. It should be noted that the nodal maximum may never be deliverable in practice.

User Specification of Zones

As part of the Ten Year Statement, National Grid NTS has proposed groupings of ASEPs into zones. The zones reflect the fact that certain ASEPs use common parts of the system. The Proposer has recommended, to change these zones, without any consultation with National Grid NTS. At the same time the Proposer has then assumed that a 1:1 exchange rate is applicable. This approach disregards the physical characteristics of the network and introduces even greater risk of increased buy back costs.

Limiting Transfers to within zone

The Proposal Mod 0150 was developed in response to User demand to take account of transfers between zones. It is also an important aspect of maximising the amount of capacity that can be transferred between entry points. As stated previously the nodal maximum is the physical capability of the local infrastructure associated with the particular ASEP and this level of physical capability can only be delivered where there are favourable supply and demand patterns. These favourable supply and demand patterns are not limited to within zone interactions, therefore if transfers between zones are not considered the potential to transfer the maximum amount of capacity to an entry point will be reduced.

Wholesale changes to the AMSEC and RMSEC processes

The original Modification Proposal 0150 does not have any impact on the working of existing auctions. Modification 0150A fundamentally changes the AMSEC and RMSEC, with the changes to be introduced from October 2007. These changes have not been discussed at all with Users or National Grid NTS. The system changes required to implement these changes could not be made within the timescales proposed. National Grid NTS considers it wholly inappropriate to put forward such fundamental changes as part of a variant to an Urgent Modification proposal.

Incorporation of an additional round in the 2007 AMSEC auction

National Grid NTS does not understand how an additional auction round can be added to the 2007 AMSEC. The 2007 AMSEC finishes on the 24 May and an Ofgem decision on this Modification proposal is not expected until the 12 June. We would therefore welcome the Proposer's views on how this would work as it is unclear from the Proposal.

Timeline for Implementation

There have been no system developments undertaken to support an AMSEC or RMSEC auction process based on zones. Therefore to assume that a further round of the AMSEC could be run incorporating a transfer process by Summer 2007 is not at all credible. To further assume that the RMSEC process can be altered to a zonal approach from October 2007 is also not credible. The AMSEC and RMSEC are fully defined and developed auction processes, with appropriate systems which the community generally understand and have significant experience of. To try to change these

auction processes as part of a variant to an Urgent Modification proposal, which does not alter these processes, with implementation dates of Summer 2007 and October 2007 is not appropriate.

Extent to which implementation of Modification Proposal 0150A would better facilitate the achievement (for the purposes of each Transporter's Licence) of the Relevant Objectives

National Grid NTS firmly believes that Mod 150A would, if implemented, not better facilitate the following Relevant Objectives as set out in its Gas Transporters Licence:

- in respect of Standard Special Condition A11 paragraph 1(a), the Proposal would provide Users at sold out ASEPs the opportunity to seek to procure unsold capacity at other ASEPs where it is most valued. While this would result in the avoidance of sterilisation of capacity and the stranding of gas offshore, the modification has the following draw backs that are not consistent with the efficient and economic operation of the NTS pipeline system:
 - In effecting a transfer it does not take into account any expected increase in costs, National Grid NTS believes this would leave Users exposed to unlimited buy back costs. In so doing it would also appear to grant extra firm rights to late bookers of capacity and penalise Users who had given long term investment signals, which we do not believe is consistent with the direction of other changes to the regime.
 - The introduction of fundamental changes to fully developed and understood processes without sufficient consultation and fully developed proposals.
 - The proposed implementation timelines are not credible, which introduces significant uncertainty in terms of when the processes could be introduced

Therefore it would be counter to the efficient and economic operation of the NTS pipeline system;

- in respect of Standard Special Condition A11 paragraph 1(c) (the efficient discharge of the licensee's obligations under this licence), the Proposal is anticipated to meet a new Licence obligation on National Grid NTS to facilitate the transfer of capacity between ASEPs in the constrained period. However the Proposal does not take account of the intent of Final Proposals or of the proposed licence drafting which states that in effecting any transfer the expected costs should not increase. In addition, the licence condition states that the transfer of capacity should be in accordance with an approved capacity transfer methodology. This proposal clearly circumvents this process and the requirement to take account of expected increases in cost, it is therefore not compliant with the intended Licence Condition.

Regards

Martin Watson
Gas Charging and Access Development Manager

Appendix: Support for Mod 150

Extent to which implementation of this Modification Proposal would better facilitate the achievement (for the purposes of each Transporter's Licence) of the Relevant Objectives

Mod 0150

National Grid NTS considers this Proposal would, if implemented, better facilitate the following Relevant Objectives as set out in its Gas Transporters Licence:

- in respect of Standard Special Condition A11 paragraph 1(a), the Proposal would provide Users at sold out ASEPs the opportunity to seek to procure unsold capacity at other ASEPs where it is most valued. This would result in the avoidance of sterilisation of capacity and the stranding of gas offshore, and thereby better facilitate the efficient and economic operation of the NTS pipeline system;
- in respect of Standard Special Condition A11 paragraph 1(c) (the efficient discharge of the licensee's obligations under this licence), the Proposal is anticipated to meet a new Licence obligation on National Grid NTS to facilitate the transfer of capacity between ASEPs in the constrained period;
- in respect of Standard Special Condition A11 paragraph 1(d), the Proposal would promote the securing of effective competition between relevant Shippers by use of a pay-as-bid auction for the allocation of any unsold capacity.