

Mr. Julian Majdanski
Joint Office of Gas Transporters
Ground Floor R
Homer Road
Solihull
B91 3QJ

Mark Freeman
Contract Manager
Mark.freeman@uk.ngrid.com

Direct tel +44 (0) 1926 656218
Direct fax +44 (0) 1926 656620

www.nationalgrid.com

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Dear Julian

Re: Modification Proposals 0116V/0116VD/0116A/0116BV/0116CV: "Reform of the NTS Offtake Arrangements"

Thank you for your invitation seeking representations with respect to the above Modification Proposal. These comments are on behalf of National Grid Gas plc (UK Distribution) ("Distribution") and to help with the Modification process we have tried to follow the format of the proforma circulated by the Joint Office as closely as possible. We have reserved the Further Comments section at the end of the response for comments on the legal text.

Distribution offer qualified support for the implementation of this Modification Proposal 0116V

Distribution support the implementation of this Modification Proposal 0116VD

Distribution do not support the implementation of this Modification Proposal 0116A

Distribution do not support the implementation of this Modification Proposal 0116BV

Distribution do not support the implementation of this Modification Proposal 0116CV

Of the proposals that we support, we would rank our support for them in the following order (most supported first):

0116VD then 0116V

We wish to qualify the above statement in that because legal text is only available for 0116V the above judgement has been made on the 0116V legal text and the nature of the alternate modification proposals and the draft modification report. This does of course introduce an element of risk into this modification process and highlights that the present process was not really designed to cope with the fundamental regime changes proposed by Mod 0116 and the alternates. In addition we would like to make it clear that we would only support these proposals if the Regulatory Impact Assessment demonstrates that the benefits outweigh the costs.

We would also like to make the comment that whilst we welcome the way the proposals have developed from when they were initially proposed e.g. the flow swap provisions that have now been added and that flow flexibility capacity is proposed to be utilized as a zonal product we still have reservations in that we feel none of the proposals address the shortcomings of the present definition of flow flexibility and there are potential issues with the proposed credit arrangements. To address the

flow flexibility issue we plan to bring forward our own proposal to change the definition of flow flexibility. The intention is that the proposal will stand alone and is applicable whether Mod 0116V or any of the alternates are implemented or not. In terms of the credit arrangements we feel that they are inconsistent with the present UNC arrangements. Further detail is provided in the Further Comments section at the end of this response.

In making the assessment between 0116V and 0116VD we see the changes introduced by 0116VD as:

- An increased tolerance for flow flex and an allowance for a negative flow flex requirement
- An earlier notification of initial prevailing rights
- Transfers can be notified up to 14:00
- NTS still liable for failure to supply where there is an overrun
- Assured pressures granted ahead of capacity requests

We feel that these are sensible changes especially with regard to the liability provisions whereby it is proposed that NTS would grant assured pressures ahead of granting capacity rights. Under the present terms in 0116V DNs would have to apply for capacity without knowing whether pressures could be assured thus potentially negating the value of the capacity and significantly increasing risk for DNs. Also we feel that the failure to supply provisions should not release NTS from their failure to supply obligations whereby a User overruns by a small amount in an unrelated part of the system.

We would like to make the following comments on the proposals that we do not support.

0116A.

At the outset we have made it clear that we support Exit Reform provided that it can be demonstrated that the case for reform can be made through the cost benefit analysis. As proposal 0116A seeks to extend the present arrangements and does not propose reform then we feel that we cannot support this proposal.

0116BV

0116BV is different to 0116V mainly in terms of:

- an increase in tolerance on flow flex measurement
- the prevailing rights for flat capacity that are given to new NTS Supply Points
- clarification on when a User does not surrender or reduce flow flexibility
- some changes to the transfer arrangements
- some changes to the charging arrangements (including splitting the neutrality pots into four areas) and increased information publication requirements.

However in 0116BV it is not clear how the additional information provisions are going to be achieved, why four neutrality areas were chosen and what the impact of this will be. Whilst we feel that Proposal 0116BV may have some merit we do not feel that the implications of the proposal are sufficiently well understood to support the proposal.

0116CV

As this proposal is essentially the same as 0116BV but proposes to retain the present flow flexibility provisions we feel that for the same reasons we presented for 0116BV we cannot support this proposal.

We do not wish to comment further on proposals 0116A, 0116BV and 0116CV. The following comments relate to 0116V and 0116VD unless otherwise stated and are subject to the provisos indicated previously and in the comments on the legal text provided in the final comments section.

Extent to which implementation of the proposed modification would better facilitate the relevant objectives

Gas Transporter Licence Standard Special Condition A11.1

- (a) ***the efficient and economic operation of the pipe-line system to which this licence relates;***

The implementation of the proposal would enable Users to provide an accurate indication of their exit capacity requirements beyond 2010 thus allowing NTS to undertake better informed investment decisions thus facilitating the efficient and economic operation of the NTS pipeline system

- (b) ***so far as is consistent with sub-paragraph (a), the coordinated, efficient and economical operation of (i) the combined pipe-line system, and/ or (ii) the pipe-line system of one or more other relevant gas transporters;***

The proposal would allow DNs to indicate their exit capacity requirements and NTS to make efficient decisions on how to provide that capacity. This relevant objective could be better met if Modification Proposal 0090 were implemented such that DNs could better trade off between contracting for interruption and providing additional infrastructure

- (c) ***so far as is consistent with sub-paragraphs (a) and (b), the efficient discharge of the licensee's obligations under this licence;***

We have already stated that we would only support this proposal if it can be demonstrated that the benefits outweigh the costs. Therefore we believe that this objective could only be achieved with a positive outcome from the regulatory impact assessment. In terms of discrimination between Users we understand why NTS would like to be able to offer the same products to all classes of Users. However we also understand that the requirements of the different classes of Users are different and these differences should be accommodated where possible. We believe a different characterisation of the use of flow flexibility would help this accommodation and we plan to bring forward our own proposal to change the definition of flow flexibility

- (d) ***so far as is consistent with sub-paragraphs (a) to (c) the securing of effective competition:***

- (i) ***between relevant shippers;***

Offering consistent products across all shippers should enable shippers to NTS connected loads to compete. However, the increased complexity of the regime may prevent some Shippers actively seeking to supply to NTS connected customers and under the proposal because shippers at DN-connected loads do not have to procure flow flexibility whereas those connected to the NTS do, a load seeking a new connection with a choice of NTS or DN connection may decide to connect to the DN rather than the NTS for this reason

- (ii) ***between relevant suppliers; and/or***

Similar comments apply to (i) above

- (iii) ***between DN operators (who have entered into transportation arrangements with other relevant gas transporters) and relevant shippers;***

There is likely to be only limited competition between DNs and shippers and this will be determined by the geography of the network and the supply and demand of capacity in those geographical areas

- (e) *so far as is consistent with sub-paragraphs (a) to (d), the provision of reasonable economic incentives for relevant suppliers to secure that the domestic customer supply security standards (within the meaning of paragraph 4 of standard condition 32A (Security of Supply – Domestic Customers) of the standard conditions of Gas Suppliers’ licences) are satisfied as respects the availability of gas to their domestic customers; and*

We have not identified any impact.

- (f) *so far as is consistent with sub-paragraphs (a) to (e), the promotion of efficiency in the implementation and administration of the network code and/or the uniform network code.*

We have not identified any impact.

The implications of implementing the Modification Proposal on security of supply, operation of the Total System and industry fragmentation

It is arguable whether there would be any industry fragmentation as a result of this proposal. The very nature of DN systems and the NTS mean that they are likely to be operated differently. However this differentiation could be reduced if this proposal and Mod 0090 is implemented as this would mean there would be a universal firm regime on both systems. There is likely to be an impact on security of supply; NTS has stated that through this proposal were an emergency to occur then it is more likely that it would progress more quickly to a Stage 3 than present. It is questionable whether there would be more rapid progression to Stage 4. In terms of operation of the System NTS argue that they would have improved system management tools. Based on the experience of the entry capacity regime we think this will depend on the appetite of users to enter into the processes used for system management.

The implications for Transporters and each Transporter of implementing the Modification Proposal, including

a) implications for operation of the System:

Our comments with regard to system management tools equally apply here

b) development and capital cost and operating cost implications:

There will undoubtedly be substantial system costs associated with the implementation of this proposal. We have already stated we would not support the proposal if the benefits outweigh the costs. This will be captured by Ofgem’s impact assessment.

c) extent to which it is appropriate to recover the costs, and proposal for the most appropriate way to recover the costs:

We acknowledge the NTS statement that costs deemed to be part of Network Sales would not be recovered from Users

d) analysis of the consequences (if any) this proposal would have on price regulation:

We have commented separately on the associated pricing consultations.

The consequence of implementing the Modification Proposal on the level of contractual risk of each Transporter under the Code as modified by the Modification Proposal

From a DN point of view we face considerable risk were the proposed regime and the associated charging mechanisms to be implemented. We look forward to working with Ofgem to put in place incentive arrangements that will ensure an efficient outcome for all concerned. For NTS the risk will be mitigated through its Price Control Review

The high level indication of the areas of the UK Link System likely to be affected, together with the development implications and other implications for the UK Link Systems and related computer systems of each Transporter and Users

NTS state that it expects the system impacts to be on existing IS infrastructure and the Gemini system and that relevant procedures will be provided as part of the consultation on this proposal. We presume that this will be a staged development with the requirement to enter into the long term processes for flat capacity in summer 07 being the first stage. We would like to record that many shippers are already likely to be trained in the use of the Gemini system – for the purposes of booking capacity many DN users are not and are therefore likely to require more detailed training. Without knowledge of the systems specification it is difficult to assess how significant this will be.

The implications of implementing the Modification Proposal for Users, including administrative and operational costs and level of contractual risk

We presume that these costs and the level of contractual risk will be reflected in the Ofgem Impact Assessment. There will no doubt be an impact on the contractual arrangements with downstream parties. From a DN point of view because of the User commitment methodology we will need to have charging arrangements in place to reflect the costs we will incur for booking capacity from the NTS. This will have a cost impact for DNs.

The implications of implementing the Modification Proposal for Terminal Operators, Consumers, Connected System Operators, Suppliers, producers and, any Non Code Party

The comments in the previous paragraph apply here.

Consequences on the legislative and regulatory obligations and contractual relationships of each Transporter and each User and Non Code Party of implementing the Modification Proposal

We have no comments on this section

Analysis of any advantages or disadvantages of implementation of the Modification Proposal

We have identified the following advantages:

- NTS will be better able to demonstrate efficient investment
- Enable Users to signal their long term capacity requirements
- Enable NTS to offer vanilla products to all classes of User
- Enable Users to place value on the capacity they require
- NTS is incentivised to take all appropriate steps to deliver gas even where there is an overrun on the system (0116VD)
- Ensure pressure requests and capacity requests are received and allocated in a coordinated manner (0116VD)

We have identified the following disadvantages:

- Increased complexity in both systems and processes which will lead to an increase in costs
- Negative impact on emergency arrangements thereby potentially damaging security of supply
- Potentially discriminatory between DN-connected loads and NTS-connected loads
- Uncertainty for Users, especially DNs, in operating in a daily capacity regime
- Depending on the charging methodology there is potential uncertainty in the charge Users will pay for capacity at the time of use

The extent to which the implementation is required to enable each Transporter to facilitate compliance with safety or other legislation

The proposed changes could impact on the NTS, DN and NEC Safety Cases, the materiality of which will need to be assessed

The extent to which the implementation is required having regard to any proposed change in the methodology established under paragraph 5 of Condition A4 or the statement furnished by each Transporter under paragraph 1 of Condition 4 of the Transporter's Licence

We acknowledge that implementation is not required having regard to any proposed change in the aforementioned methodology.

Programme for works required as a consequence of implementing the Modification Proposal

The impact on systems changes has been mentioned previously

Proposed implementation timetable (including timetable for any necessary information systems changes)

We note the proposed timetable for implementation. We would like to make the point that there is an interaction with the proposed revised interruption arrangements (Mod 0090). Because NTS Exit Capacity is scheduled to be sold in July 2007 for DNs to be able to make an efficient trade off of capacity products and bid into the NTS process they need to be able to sell interruptible rights in May 2007. As detailed in our response to the consultation on the Exit Capacity Release Methodology at this time we would also need certainty over the NTS Exit Capacity prices.

Implications of implementing this Modification Proposal upon existing Code Standards of Service

We have no comments on this section.

Further Comments

The comments on the legal text are limited to proposal 0116V as this is the only legal text available; some of these points (particularly that on J7.2.1) would not be applicable if text for 0116VD was available.

Liability Pass through - J7.2.1

We recommend removal of this paragraph, it is inappropriate and potentially lead to disproportional risk and financial exposure.

Exceeding booked capacity is a recognised potential occurrence and remedied under the proposed Code rules by levying a predetermined charge. It should not be linked to a liability that falls on NTS. The incentive to make appropriate bookings lies within the booking incentive not with the need to offset a failure to perform by third parties to deliver services from which the user may be totally removed. There is not even a "cause & effect" test within the proposed rules. For a User to offset this risk would lead to the inefficient over-booking of capacity.

Additionally, the existing paragraph V8 specifically prevents this type of liability offsetting and therefore this drafting, as it stands, we believe would be inconsistent with the existing general provisions of the Code.

Credit Arrangements - V3.3.4

We recommend removal of this paragraph, it is inconsistent with the present provisions of the UNC and is inconsistent with Ofgem's Credit Consultation recommendation.

The proposed rule states that a User's "Relevant Code Indebtedness" includes 12 months' worth of Exit Capacity Charges. For all other transportation charges the indebtedness is based on a nominal 2 months' peak invoices. A 12-month indebtedness calculation would be discriminatory and inconsistent with the rest of the transportation credit regime and is a potential barrier to entry. There is currently a modification proposal to reduce the indebtedness calculation to the equivalent of 45 days average invoiced amount.

Capacity Assignment - B6.2.3(a)

This works differently to existing supply point transfer arrangements. Currently, where a shipper takes on a commitment that would take it over its credit arrangement, the transfer is facilitated and the credit cover sorted out afterwards. The rules here state that the transfer does not occur until the credit is put in place. Whilst this is not a big issue for DN Users we believe this could be a significant issue to shipper Users and could be a potential barrier to supply-side competition.

Gas not made available for offtake – J3.5.8

It is not clear how the failure to supply provision works in relation to flexibility capacity.

Typographical errors

We have noticed two typographical errors in the following paragraphs:

G2.3.2 (h) ...this should read "an LDZ Supply Point, the Transportation Charges"

G7.4.1(b)(i)...the "Z" can be deleted

I hope you find these comments helpful.

Yours sincerely,

Mark Freeman