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The Joint Office, Relevant Gas
Transporters and other interested
parties

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Dear Colleague,

**National Grid NTS's application under the UNC to not release Unsold Capacity
in the 2005 QSEC auction**

On 4 October, Ofgem issued its final decision letter on modification proposal 0043 under the Uniform Network Code (UNC) approving the implementation of this proposal¹. This modification proposal provides National Grid NTS with the discretion not to offer baseline and obligated incremental capacity for sale (through the long, short and medium term auctions) under certain circumstances, subject to Authority consent².

On 7 October 2005, National Grid NTS submitted to the Authority, a formal application for consent under the UNC not to release unsold capacity in the 2005 QSEC auction with respect to the Milford Haven Aggregate System Entry Point (ASEP) for calendar quarters over the period October 2007 to September 2008. This followed the completion of an industry-wide consultation, by National Grid NTS, in respect of its proposed application to allow shippers and other interested parties to make representations.

Ofgem³ has considered the issues raised by National Grid NTS's formal application and the views of respondents, and, having regard to the principal objective and statutory duties of the Authority⁴, has decided to consent to National Grid NTS's application.

¹ UNC modification proposal 043 'Limitation on offering for sale unsold capacity', Ofgem, 4 October 2005.

² Further background to modification proposal 0043 is found in the Ofgem decision letter.

³ Ofgem is the Office of the Gas and Electricity Markets Authority. The terms 'Ofgem' and 'the Authority' are used interchangeably in this letter.

⁴ Set out in Section 4AA of the Gas Act 1986, as amended.

National Grid NTS's consultation

On 21 September, National Grid NTS issued a consultation on its proposed application to the Authority for consent not to release the amounts of Unsold Capacity in the 2005 QSEC auction of entry capacity at the Milford Haven ASEP as set out in Table 1 below.

Table 1:

Quarter	Total booked capacity (GWh/d)	Obligated Capacity (GWh/d)	Unsold Capacity (GWh/d)
Q4 2007	452	650	198
Q1 2008	650	650	0
Q2 2008	552	650	98
Q3 2008	552	650	98

In its consultation National Grid NTS stated its commitment to delivering the connecting pipeline from Milford Haven by October 2007 but stated that, whilst also being committed to delivering the downstream reinforcements in a timely fashion, there are inherent risks, including the potential for the project to be affected by significant external factors beyond National Grid NTS's control, such as planning permissions and easements from landowners.

Furthermore, National Grid NTS stated that it was separately mindful that Ofgem must have regard to the potentially significant costs that shippers (and potentially customers) may be exposed to through capacity neutrality in the event of any buy back of capacity offered for sale and sold.

However, National Grid NTS stated that further analysis and assessment of the engineering and consents issues over the coming months should provide a clearer indication of the timetable for the completion of the reinforcement work and may allow for the currently unsold capacity to be auctioned at a later date.

Respondents' views

National Grid NTS received 3 responses to its consultation, none of which were confidential.

One respondent commended the information provided and noted that this enabled a more realistic assessment of the implications of such restrictions. This respondent stated, however, that they had some difficulty in identifying which of the factors highlighted in the consultation were evident at the time of the original offer of the capacity in the LTSEC process of 2004, and which have only become known at this later date.

This respondent expressed concern that it is all unsold capacity that is to be withheld as this implies that the level of capacity actually available over this period is lower than the lowest level of capacity booked. This respondent noted that, if this is the case, some level of buyback will be required through this period. Given the situation, this respondent conceded that it is prudent not to exacerbate the situation by selling even more capacity that is not physically available. However, this respondent stated that it was inappropriate to simply limit the capacity offered for sale without re-visiting the revenue, incentive and sharing arrangements as to do so would compromise the established distribution of risk and reward between industry parties.

Another respondent welcomed the level of transparency that National Grid Gas had adopted in its consultation, and offered qualified support for National Grid NTS's proposal stating that the forced release of unsold capacity at Milford Haven, would lead to costs for customers and would not represent economic and efficient operation of the pipeline system. This respondent also noted that the nature of the proposal raised security of supply questions that are outside the scope of the consultation.

Another respondent expressed surprise that, given National Grid NTS had only recently committed to make such capacity available having applied the relevant economic tests, it now wished to withhold it from the market. This respondent stated that the information presented was inadequate and it was unable to make an informed judgement as to whether or not the application is reasonable. This respondent stated that further information should be provided to the Authority providing details of the "significant" potential buy back costs involved as well as the SO incentive revenues associated with the designation of this capacity as obligated. This respondent stated that consideration should be given to whether the revenue associated with such unsold capacity should be deducted from SO allowed revenue, rather than any shortfall being recovered from shippers via the SO charging framework.

National Grid NTS's formal application

On 7 October 2005, following consideration of respondents' views, National Grid NTS submitted its formal application, including the provision of certain confidential information. This application was substantively unchanged relative to the proposed application consulted upon on 21 September 2005⁵.

Ofgem's decision

Ofgem hereby consents to National Grid NTS's application, under the UNC, not to release the amounts of Unsold Capacity specified in the 2005 QSEC auction of entry capacity at the Milford Haven ASEP for calendar quarters over the period October 2007 to September 2008 as indicated in Table 1 above. In reaching this decision, Ofgem has considered National Grid NTS's formal application, the views expressed by respondents to National Grid NTS's consultation, and independent consultancy advice received on the technical, engineering aspects of National Grid NTS's application.

Ofgem would note that, due to external factors beyond National Grid NTS's control, significant uncertainties remain associated with delivering the necessary downstream reinforcement at Milford Haven. Given the potential scale of losses, should such external factors delay the delivery of the necessary reinforcement, Ofgem believes that granting this consent is consistent with the Authority's statutory duties and the principal objective of the Authority to protect the interests of customers.

However, it is Ofgem's view that, once the position is more certain, these issues could be revisited and, if appropriate, National Grid NTS should be encouraged to auction the additional capacity at Milford Haven for the calendar quarters specified. Indeed, National Grid Gas plc has stated that, given the uncertainty of the present position, it does not propose to apply for consent to be relieved of its "all reasonable endeavours" obligation under Special Condition C8B(14)(5)(f)(ii)(a) of its licence at this time. As such, National Grid Gas continues to face an "all

⁵ The non-confidential elements of this formal application were circulated by the Joint Office on 12 October 2005.

reasonable endeavours" obligation to offer for sale all obligated entry capacity to gas shippers such that all obligated entry capacity has been sold at the end of the relevant gas day.

Going forward

With respect to the timetable for consideration of the application, Ofgem considers that the issues raised by modification proposal 0043 which ultimately resulted in this application being raised, should have been brought forward at an earlier stage by National Grid NTS to facilitate a more timely consideration of the issues and the subsequent applications ahead of the long term auctions. In particular, we would encourage National Grid NTS to ensure that it brings forward any applications it may wish to make in a timely manner and well before the long term auctions.

Consistent with the views expressed by one of the respondents to this consultation, Ofgem is planning to consult on changes to National Grid NTS's incentive arrangements with a view to ensuring that it faces strong incentives to deliver capacity at Milford Haven in an efficient and timely manner.

If you wish to discuss any aspect of this letter, Mark Feather (telephone 0207 901 7437) would be pleased to assist.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Robert Hull', with a horizontal line underneath.

Robert Hull
Director, Transmission