

Modification proposals:	<b>Uniform Network Code (UNC): Reform of the NTS offtake arrangements (UNC 0116V, 0116BV, 0116CVV, 0116VD and 0116A)</b>		
Decision:	<b>The Authority<sup>1</sup> directs that proposal 0116V be made<sup>2</sup></b>		
Target audience:	<b>The Joint Office, Parties to the UNC and other interested parties</b>		
Date of publication:	<b>5 April 2007</b>	Implementation Date:	<b>Delayed until 1 April 2008</b>

## Background to the modification proposals

The introduction of new gas offtake arrangements was first raised in the context of the gas distribution network sales process (GDN sales) which was completed in June 2005. At the time of GDN sales it was considered important by the Authority that the fragmentation of ownership of the gas transportation network did not create the potential for inefficient investment or inefficient operational decisions at the new commercial interface between the National Transmission System (NTS) and the GDNs. In order to address these concerns it was proposed by Ofgem that GDNs and shippers that represent transmission connected customers (TCCs) should have equal and non-discriminatory access to the NTS. When the Authority gave its consent to GDN sales it included the introduction of a proposed enduring offtake framework as a condition of this consent.

In June 2005, in response to considerable industry opposition, the Authority decided to delay the introduction of enduring offtake arrangements to allow for further consultation in parallel with the Transmission Price Control Review (TPCR). As a consequence of this, a set of 'transitional offtake' arrangements was put in place.

Since this time, there has been considerable consultation on the proposed reforms which are intended to take effect in mid 2007 for the allocation of offtake rights from October 2010. This consultation was undertaken through the Transmission Price Control Review (TPCR) and then subsequently the UNC modification processes.

## The modification proposals

The proposals that have been raised are the National Grid Gas (NGG) NTS proposal 0116V, 'Reform of the NTS offtake arrangements' together with a series of three alternative proposals raised by British Gas Trading (BGT), Scotia Gas Networks plc (SGN) and RWE npower (RWE) which take the NGG proposal as its basis and seek to vary it. A further proposal has been raised by E.ON which does not provide for fundamental reform but instead provides for the existing 'transitional offtake arrangements' to continue.

### *Modification proposal 0116V – The NGG proposal*

The NGG proposal is intended to address a number of concerns that Ofgem has expressed in relation to the 'transitional offtake' arrangements. The main concerns are as follows:

<sup>1</sup> The terms 'the Authority', 'Ofgem' and 'we' are used interchangeably in this document. Ofgem is the Office of the Gas and Electricity Markets Authority.

<sup>2</sup>This document is notice of the reasons for this decision as required by section 38A of the Gas Act 1986.

- GDNs and shippers purchase different offtake products and face dissimilar terms of access even though both classes of user place similar demands on the NTS;
- there are separate offtake booking arrangements for GDNs and shippers;
- under the existing interruption arrangements some users receive materially different levels of service from NGG NTS but receive the same discount from transportation charges;
- the arrangements do not provide for users to signal their long term requirements for network capacity and, therefore, potentially create risks that NGG NTS may undertake investment in the network which turns out not to be necessary and for which customers bear the costs; and
- existing shippers are provided with evergreen rights to capacity whilst new users whose capacity requests trigger incremental investment cannot obtain immediate access to the system.

The NGG proposal seeks to address these concerns by:

- facilitating the introduction of increased levels of financial commitment for all NTS users (both new and existing) seeking to obtain access to the NTS. It is noted however that the NGG proposal proposes a new system of “prevailing rights” for existing users of the NTS under which these users are assumed to hold their rights of access unless they provide notice to the NTS that they no longer require them. By contrast new users are required to make a greater level of financial commitment in order to secure capacity;
- reforming the network interruption arrangements such that the discounts provided more closely reflect the service provided by NGG NTS and the probability of interruption; and
- releasing NTS flexibility rights to GDNs and shippers primarily through annual auctions.

#### *Modification proposal 0116A – “The E.ON proposal”*

The E.ON alternative modification proposal 0116A, ‘Reform of NTS offtake arrangements’ seeks to maintain the status quo by removing the sunset clause set out in the UNC that currently means the transitional offtake arrangements will expire on 30 September 2010.

#### *Modification proposal 0116BV – “The RWE proposal”*

The RWE alternative modification proposal 0116BV, ‘Reform of NTS offtake arrangements’ takes the NGG NTS proposal as its basis but amends particular aspects of that proposal. In particular, the modification, amongst other things:

- increases the tolerance for the flexibility product so that users would be able to use more NTS flexibility capacity before overrun charges would be incurred;
- provides that overrun charges are only payable in respect of flexibility rights on days when the demand for NTS flexibility exceeds the volume available;

- allows users to signal their requirements for incremental flat capacity rights outside of the July booking window;
- provides for sites that are commissioned after 1 July 2007 and before 1 October 2010 to secure firm prevailing flat capacity rights; and
- provides for NGG NTS to release more information regarding the operation of the flexibility arrangements including forecast and actual utilisation of flexibility capacity and flexibility overrun quantities.

*Modification proposal 0116CVV – “The BGT proposal”*

The BGT proposal takes the NGG proposal as its basis but proposes the removal of the requirement on users to apply for the flexibility capacity product beyond that already existing in the UNC.

Under this proposal, therefore, DNs would continue to acquire flexibility capacity but the release of the product would not be extended to shippers representing TCCs. Instead, NGG NTS would be required to introduce a regime of monitoring and publishing information on flexibility capacity utilisation going forward. In the event that NGG NTS was unable to meet the demand for flexibility capacity on any gas day, then NGG NTS would reject nominations of those users that had not submitted an offtake profile that was consistent with their holdings of flexibility capacity.

The BGT proposal also adopts a number of the changes suggested in the RWE Trading proposal including the release of information relating to forecast and actual use of flexibility close to the gas day and providing users with the ability to signal requirements for incremental flat capacity outside of the annual July application window.

*Modification proposal 0116VD – “The SGN proposal”*

This proposal, which has been raised by Scotia Gas Networks (SGN), also takes the NGG proposal as its basis with certain variations. These include:

- increasing the tolerance for the flexibility product so that users would be able to use more NTS flexibility before overrun charges would be incurred;
- notification of prevailing rights by 1 May 2007 (rather than July) – under the proposal the annual capacity applications would occur in July as proposed by NGG NTS;
- allowing the deadline for notification of transfers of flexibility capacity between zones to be extended from 12:00 to 14:00 hours ahead of the gas day;
- changes in the NGG NTS liability provisions for where it has failed to make gas available for offtake; and
- bringing forward the date against which offtake pressure requests are submitted by DNs to NGG NTS and subsequently confirmed by the NTS.

## **UNC Panel<sup>3</sup> recommendation**

The UNC Panel met to consider the 0116V, 0116BV, 0116VD, and 0116A proposals on the 22 December 2006. It voted by majority to reject proposals 0116V, 0116BV and 0116VD. The UNC panel recommended approval of 0116A.

The UNC Panel met to consider proposal 0116CVV on the 8 January 2007. It voted by majority to reject this proposal.

## **Impact assessment and consultation**

Following the Authority's decision to delay implementation of the enduring offtake arrangements in July 2005, Ofgem has undertaken further consultation on the development of these arrangements through the Transmission Price Control Review (TPCR) process. As part of this process, Ofgem established the Enduring Offtake Working Group (EOWG), comprising a broad cross-section of the industry, including customers in January 2006. The EOWG was chaired by an Ofgem representative and has extensively debated the development of the offtake arrangements over the course of 15 meetings between 4 January 2006 and 23 August 2006.

Ofgem issued an initial impact assessment in June 2006<sup>4</sup> and a final impact assessment on the modification proposals relating to the reform of enduring offtake arrangements<sup>5</sup> in February 2007.

The final impact assessment considered the potential costs and benefits of the above proposals from both a quantitative and qualitative perspective. The impact assessment compared the potential costs and benefits of the enduring offtake modification proposals 0116V, 0116BV, 0116CVV and 0116VD with extending the 'transitional arrangements' beyond 30 September 2010 as proposed under 0116A.

The Authority welcomes the effort and resource that the industry has contributed to the development of the offtake arrangements through the TPCR process and subsequent UNC modification processes. The Authority also welcomes the development of the alternative proposals and recognises the strength of views held by industry participants on these issues.

## **The Authority's decision**

The Authority has considered the issues raised by the modification proposals and the Final Modification Reports (FMR) dated 22 December 2006 and, in the case of proposal 0116CVV, the FMR dated 8 January 2007. The Authority has considered and taken into account the responses to the Joint Office's consultation on the modification proposal which are attached to the FMR<sup>6</sup> and responses to the final impact assessment. The Authority has concluded that:

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<sup>3</sup> The UNC Panel is established and constituted from time to time pursuant to and in accordance with the UNC Modification Rules

<sup>4</sup> Transmission Price Control Review: Initial Proposals, Appendix 17 – Draft Enduring Offtake impact assessment, Ofgem, June 2006.

<sup>5</sup> National Grid Gas – Offtake Arrangements: Final Impact Assessment on modification proposals, Ofgem, February 2007.

<sup>6</sup> UNC modification proposals, modification reports and representations can be viewed on the Joint Office of Gas Transporters website at [www.gasgovernance.com](http://www.gasgovernance.com). The Joint Office has created a web page on offtake reform which can be found at <http://www.gasgovernance.com/Code/Modifications/NTSReform/>

1. **implementation of modification proposal 0116A would not better facilitate the achievement of the relevant objectives of the UNC<sup>7</sup>;**
2. **implementation of each of modification proposals 0116V, 0116BV, 0116VD and 0116CVV would better facilitate the achievement of the relevant objectives of the UNC;**
3. **implementation of each of proposals 0116V, 0116BV and 0116VD would better facilitate the relevant objectives to a greater extent than 0116CVV and proposal 0116V would do so to a greater extent than 0116BV and 0116VD; and**
4. **of these proposals, 0116V best meets the Authority's principal objective and is consistent with the Authority's statutory duties<sup>8</sup>.**

**The Authority therefore directs that modification proposal 0116V be implemented. The Authority also recommends that the implementation of 0116V should be delayed by one year to 1 April 2008 for the reasons set out in this letter.**

### **Reasons for the Authority's decision**

In this section we set out the key issues considered by the Authority in reaching its decision. We then consider the Authority's assessment of the proposals against the relevant objectives and its statutory duties.

#### *Key benefits of reform*

The Authority considers that modification proposal 0116V would provide a number of benefits to customers, including:

- the introduction of a user commitment framework which should improve the investment signals received by NGG NTS to inform and improve its investment and planning processes. The Authority considers that improved investment signals should bring about more efficient NTS investment and reduce the risk that customers will have to pay for investment by NGG NTS that proves to be unnecessary or inefficient;
- the introduction of auctions for flexibility capacity which should reduce the potential for undue discrimination between GDNs and shippers in the allocation of flexibility. It should also provide important information regarding the market value of flexibility; and
- the reform of the NTS interruption arrangements such that the discounts provided to sites more closely reflect the services provided by NGG NTS and the probability of interruption. The Authority considers that the reform of these arrangements should reduce potential for undue discrimination between firm and interruptible customers and should promote competition between shippers in offering interruption terms to the NTS.

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<sup>7</sup> As set out in Standard Special Condition A11(1) of the Gas Transporters Licence, see: [http://62.173.69.60/document\\_fetch.php?documentid=6547](http://62.173.69.60/document_fetch.php?documentid=6547)

<sup>8</sup>The Authority's statutory duties are wider than matters which the Panel must take into consideration and are detailed mainly in the Gas Act 1986.

The Authority notes that proposals 0116BV and 0116VD (the RWE and SGN proposals) also provide similar benefits. However, whilst aspects of one or more of these proposals (such as the release of flexibility information in 0116BV) would provide incremental benefits to customers, the Authority considers that these would be outweighed by the extension of flexibility tolerances set out in these proposals. Further discussion of the Authority's reasoning is set out below.

#### *Non-discriminatory allocation of flexibility product*

A key issue for the Authority in assessing the proposals put forward is whether the continuation of the present arrangements for the allocation of flexibility, as proposed in modification proposals 0116A and 0116CVV, would amount to undue discrimination as between GDNs and shippers. The Authority considers that whilst the present arrangements appear unduly discriminatory in nature, it is important also to consider whether any such discrimination is justifiable.

The Authority accepts that there are considerable uncertainties present in assessing whether the discrimination can be justified. These uncertainties relate principally to the risk of constraints in the provision of flexibility in the future and the costs that would be imposed on market participants in participating in flexibility auctions and flexibility trading as well as monitoring their flexibility requirements.

In view of these uncertainties the Authority has not concluded on whether the arrangements as proposed in 0116A and 0116CVV constitute unlawful discrimination. Instead, it has considered the issues of discrimination as part of its assessment of the proposals against the relevant objectives, the statutory duties of gas transporters and the Authority's own principal objective and statutory duties. An important consideration for the Authority in this assessment is whether the introduction of equivalent access arrangements for flexibility is consistent with its better regulation duties.

In reaching its decision, the Authority has therefore been required to make a judgement on the balance between the costs of reform and the practical risk of constraints in the availability of the flexibility product and in particular, whether the likely costs of reform are sufficiently high as to provide an objective justification for the discriminatory arrangements.

Having assessed these factors, the Authority does not consider that it would be appropriate for the existing arrangements to continue indefinitely as proposed in modification proposals 0116A and 0116CVV.

The Authority recognises that the introduction of equivalent access arrangements for flexibility rights will impose costs upon industry participants and ultimately customers. However, the Authority considers that whilst these costs are potentially material, they do not justify the continuation of the existing arrangements for flexibility.

Whilst current evidence suggests that there is sufficient flexibility available to the market, this may not necessarily be the case in the future, particularly as GDNs may reduce their reliance on their own network's flexibility going forward. Given the potential risks and uncertainties associated with flexibility constraints arising in the future, the Authority considers that it would be proportionate and in line with its better regulation duties to approve the introduction of non-discriminatory arrangements for the release of flexibility. A further discussion of the better regulation issues appears below.

In reaching this view, the Authority carefully considered the views of respondents that the differences in treatment of shippers and GDNs were justified. The Authority does not accept these arguments. The Authority recognises that GDNs are, in contrast to shippers, subject to price control regulation whilst shippers compete in a market.

However, both classes of user impose costs on NGG NTS's pipeline system which do not vary according to the type of user they are. Further, based on the capacity booking framework that was established through the GDN sales process, in booking NTS offtake capacity GDNs are acting, in effect, as agents on behalf of shippers (and ultimately end customers) and are therefore in the same position as shippers acting for TCCs. In addition, the Authority is consulting, through the Gas Distribution Price Control Review (GDPCR) on incentive mechanisms to encourage GDNs to make commercial trade-offs between the cost of procuring flexibility capacity on the NTS and investing to provide such capacity on their own networks.

#### *The costs of reform – transporter costs*

Ofgem's Final Impact Assessment published in February 2007 included a quantitative analysis that suggested that the net benefits associated with accepting 0116V were approximately £8m. The net benefits associated with proposals 0116BV and 0116VD were in the range of approximately £12m to £14m. The net benefits associated with accepting proposal 0116CVV were greater, at around £47m.

However, a number of respondents to the Final IA, in particular GDNs, raised concerns regarding the potential exclusion of transporters' costs associated with the introduction of enduring offtake reform. After consideration of these responses, and a review of previous statements made by the Authority on the treatment of operational costs of GDNs in a divested industry structure, the Authority now accepts that it would be unreasonable to exclude ongoing operational costs to GDNs. The Authority considers that the operational costs of GDNs should be subject to comparative analysis and benchmarking in future price controls in the normal manner. On this basis, the cost analysis has been revised to include the ongoing operational costs that have been submitted.

It should be noted that in this revision of the cost/benefit analysis, there should be no expectation, on the part of GDNs or any other party, as to whether the cost figures submitted to Ofgem as part of the offtake IA process will be accepted by the Authority in the forthcoming GDN price control review (GDPCR) process. As noted above, the Authority considers that any cost figures that are submitted as part of the GDPCR process should be subject to the normal review and comparative benchmarking process.

The revised analysis indicates that, for the proposals, other than 0116A and 0116CVV, there are net costs in the range of £20m to £28m. In the case of modification proposal 0116CVV net benefits are approximately £16m.

The Authority also considered a case in which GDN costs were included but shipper costs were based on the costs of the lowest four shipper submissions. On this basis, the net costs of proposals 0116V, 0116BV and 0116VD are in the range of £1m to £7m.

#### *Impact of quantitative analysis*

Whilst the quantitative analysis outlined above indicates that in some scenarios only 0116CVV provides estimated net benefits, the Authority is of the view that the reform of the NTS offtake arrangements represents an area where there are considerable uncertainties associated with both the costs and the benefits of the various modification proposals. For example, the potential benefits of non-discrimination and competition are inherently diffuse and difficult to quantify. In this respect, the Authority would note that the quantitative benefits analysis in the Final IA did not attempt to quantify all of the benefits that were identified. By contrast the transaction and implementation costs are in

principle more direct and measurable and the costs figures provided by industry participants have been incorporated into the quantitative analysis largely as provided.

In this respect, the Authority also shares the concerns outlined in the Final IA that the cost data submitted may represent an over-estimate of the costs of reform, particularly if major flexibility constraints do not occur in practice. In addition, the Authority notes that the cost information provided does not take into account the likelihood that, over time, and with experience of the flexibility regime, costs incurred may fall.

At the same time, the Authority also recognises that the assumptions underlying the quantitative benefits analysis are subjective in nature and subject to variation.

Given these uncertainties, the Authority considers that it is important not to give undue weight to the detailed results of the quantitative analysis particularly when compared with the qualitative analysis. Given the uncertainties and the margins of error in assessing both the costs and benefits in this case, the Authority considers that unless the quantitative analysis indicates that the net costs would be disproportionately high, then it should proceed on the basis that the principles of non-discriminatory access and the promotion of competition (as identified in the qualitative impacts assessment) should prevail. Further, the Authority also notes that its duties require it to protect the interests of customers and not simply to maximise the quantifiable benefits of reform. As such, the Authority does not consider that establishing a positive quantitative benefits case is a necessary a pre-requisite to accepting proposals 0116V, 0116BV or 0116VD.

The Authority considers that the Final IA and the subsequent revisions to this analysis (as set out above) identify a plausible estimate of the costs and benefits. However, the uncertainties in the assumptions underpinning the cost and benefits analysis are such that a plausible alternative range of outcomes could arise, including estimated net benefits outcomes and different net cost outcomes. Taking this into account, the Authority does not consider that the analysis demonstrates that the net costs would be disproportionately high or that there is an overwhelming case to justify rejection of proposal 0116V, 0116BV or 0116VD on the basis of the quantitative analysis. The Authority considers it important to give weight to the principles of non-discrimination and competition as identified in the qualitative analysis, which in the Authority's view demonstrates potentially significant benefits arising from proposal 0116V.

### *Prevailing rights*

In reaching its decision to approve modification proposal 0116V, the Authority identified some concerns in relation to the prevailing rights model for the allocation of flat capacity. The Authority notes that the prevailing rights model clearly differentiates between existing holders of capacity and parties requiring incremental rights. The Authority therefore has some concerns that the requirement for parties seeking incremental rights to provide greater levels of user commitment relative to existing capacity holders could potentially distort competition between new and existing users of the network. Similarly, the grandfathering of rights into the enduring offtake framework under proposal 0116V could lead to circumstances where new users are denied the opportunity to compete with existing holders for existing capacity.

However, the Authority recognises that the prevailing rights model has been subject to significant industry consultation and that few concerns have been raised in this context by parties seeking or potentially seeking incremental capacity.

The Authority also recognises the concerns raised by industry participants through the GDN sales process regarding the introduction of alternative and more complex capacity allocation frameworks such as capacity auctions.



The Authority also noted that there is no evidence of significant offtake capacity constraints on the NTS at this time (other than limited constraints in the south west of England). As such, granting prevailing rights to existing capacity holders, at this time, should not prevent users obtaining access to the NTS.

In the light of all of these considerations, the Authority does not consider that its concerns about prevailing rights would require it to reject the proposal. However, the Authority considers that it will be important for NGG NTS to keep the prevailing rights arrangements under review to ensure that they do not in future give rise to undue discrimination, particularly if offtake constraints appear or if evidence emerges that the framework is leading to distortions in competition between users.

The Authority also notes that its decision on prevailing rights for gas offtake does not necessarily indicate that a similar approach would be appropriate for the allocation of capacity rights more generally across the gas and electricity networks. In considering the application of prevailing rights to capacity allocation in other areas the Authority would have regard inter alia, to the factors identified above; i.e. whether the network is constrained and capacity is scarce, and whether there is evidence that prevailing rights would lead to distortions in competition between network users in downstream markets.

***Relevant Objective (a) (Standard Special Condition A11(1)(a)) the efficient and economic operation of the pipeline system to which this licence relates***

The Authority considers that, with the exception of modification proposal 0116A, all of the proposals would better facilitate the efficient and economic operation of the pipeline system.

*Improved information*

Each of proposals 0116V, 0116CVV, 0116VD and 0116BV would enable NGG NTS to receive more robust information from users, which is backed by a greater financial commitment than is currently the case. In the Authority's view, this should incentivise users to consider more carefully the signals they send to NGG NTS regarding their anticipated future use of the transmission network. The receipt of robust information from user commitments should bring about more efficient NTS investment and reduce the risk of stranded assets.

The Authority considers that the introduction of a user commitment model for gas offtake is particularly important within the current commercial environment where there are significant uncertainties in the market place, particularly regarding potential storage and gas fired power generation investment. In particular, both uncertainty over future electricity and carbon prices and greater gas price volatility (as the UK becomes more reliant on international sources of supply) increases the risk that new generation loads which trigger investment on the NTS may not go ahead or may subsequently mothball, potentially stranding significant network investments. The introduction of user commitment models should reduce the risk, for customers generally, of stranded investment in transmission assets, thereby better facilitating objective (a).

In reaching this conclusion, the Authority has noted the views of some respondents that it is preferable for NGG to manage the risk associated with investment on the NTS. The Authority however considers that the proposed framework improves the allocation of risk between industry participants and customers. In particular, the Authority believes that TCCs and their shippers are best placed to manage the risks associated with whether investment should be triggered on the NTS. The Authority considers that the provision of

financially backed commitments from users is preferable to relying on NGG NTS undertaking a more centralised planning process which is based on forecasts and voluntary information submitted by users and where the risks of unnecessary investment may be borne by customers rather than those parties that have triggered the investment.

It is also noted that each of proposals 0116V, 0116BV, 0116CVV and 0116VD establish a framework for existing capacity and new capacity holders to provide greater levels of user commitment than is currently the case.<sup>9</sup> Under the proposals existing holders of capacity would be required to provide a minimum period of notice to NGG NTS should they wish to cease using offtake capacity. This requirement should help NGG NTS in identifying network capacity that is not likely to be required in the future and should, in some circumstances, help it to avoid unnecessary investment. The Authority considers therefore that this should better facilitate objective (a).

The Authority recognises the views raised by respondents that the user commitment model has been established primarily for flat capacity as opposed to flexibility, where NGG NTS has indicated that it is unlikely to invest. However, notwithstanding this, the Authority also considers that the introduction of market based pricing of flexibility, combined with the incentives on NGG NTS to release more flexibility where it is available, should also provide benefits in terms of useful and important information regarding the true level and value of flexibility on the NTS. The benefits of market based pricing of flexibility are discussed further below under objective (b).

Concerns were also expressed that the application of a user commitment framework to storage facilities would not provide any additional investment signals to NGG NTS, to those already provided through the entry capacity auction framework at a bi-directional entry/exit point.

The Authority would however note that, as part of the TPCR framework, NGG NTS will be required to use reasonable endeavours to increase offtake capacity baselines in the event that offtake capacity is generated as a result of entry investments being undertaken. Any such increases in offtake capacity baselines should therefore reduce the likelihood that a shipper would need to provide long term user commitments for incremental offtake capacity at a bi-directional storage offtake point where investment signals have already been provided under the entry capacity framework.

Some respondents have raised concerns that the proposed arrangements would have negative impacts on security of supply. These issues are considered further below.

#### *Market based interruption arrangements*

The Authority considers that the introduction of market based arrangements for interruption, as opposed to voluntary shipper interruption should provide NGG NTS with improved signals and more robust information. This should assist it in comparing the costs of entering into network interruption contracts with the costs of physically investing in the transmission network.

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<sup>9</sup> Under the current arrangements existing users can roll over their capacity rights at one month's notice, whereas users requiring incremental capacity rights are generally required to enter into an Advanced Reservation of Capacity Agreement committing them to pay 1 year's capacity charges.

### *Flexibility proposals*

The Authority considers that the introduction of the flexibility arrangements provided for in proposals 0116V, 0116BV and 0116VD should, on occasions when flexibility is scarce, reduce the likelihood that NGG NTS will be required to take gas balancing actions to manage within day flow variations. This is because the flexibility arrangements should ensure that the costs of offtake flow variations are targeted to the TCCs and GDNs. On this basis, these proposals should better facilitate the efficient operation of the NTS to a greater degree than proposal 0116CVV.

It is noted that proposals 0116BV and 0116VD provide for the introduction of a greater flexibility tolerance level relative to 0116V. The flexibility tolerance level represents a cushion for GDNs and shippers to avoid incurring overrun charges as a result of failing to book sufficient capacity. The proposals provide for an increase in this tolerance level of 1.5% to 3%. The Authority does not believe that the greater level of flexibility tolerances set out in these proposals would better facilitate objective (a). Indeed, allowing GDNs and shippers to overrun to a greater degree without incurring overrun charges could have detrimental effects on the efficient operation of the NTS. For example, such overruns could potentially trigger constraints on the system, the costs of which would not be borne by the parties that caused them.

It is also noted that the level of flexibility capacity that NGG NTS would be required to release has been determined through the Transmission Price Control Review process, where the Authority determined a baseline level of flexibility that NGG NTS would be required to offer for sale in the auctions (should such auctions be implemented). We consider that the introduction of an increased flexibility tolerance is inconsistent with this baseline level.

For these reasons, the Authority believes that 0116V better facilitates objective (a) to a greater extent than 0116VD and 0116BV which propose the introduction of a larger tolerance band.

### *Applications for flat capacity – the booking window*

The Authority notes that proposal 0116BV provides for more flexibility to be introduced into the timetables for the release of flat capacity at new exit points. The Authority agrees with the proposer that there are merits in incorporating sufficient flexibility to allow parties to apply for capacity outside of the proposed July application window, provided it is economical for the NTS to release such capacity given its investment lead time. In this respect, the Authority notes that under the Transmission Price Control Review as agreed by NG, specific investment lead time periods have been set for the release of incremental flat offtake capacity. These lead times are also associated with the NTS investment buy back incentive. A reduced investment lead time may increase the risk that NGG NTS might need to buy back capacity if it cannot invest in time. Careful consideration would need to be given to these factors were any additional flexibility in timing introduced into the regime going forward.

### *The Authority's view against relevant objective (a)*

The Authority considers that proposals 0116V, 0116BV, 0116CVV and 0116VD would all better facilitate the achievement of this objective.

The Authority also considers that 0116V, 0116BV and 0116VD would better facilitate objective (a) to a greater extent than 0116CVV and that 0116V would better facilitate objective (a) to a greater extent than 0116BV and 0116VD.

The Authority does not consider that 0116A would better facilitate the achievement of this objective.

***Objective (b): the coordinated, efficient and economic operation of (i) the combined pipeline system, and/or (ii) the pipeline system of one or more other relevant gas transporters***

The Authority considers that the introduction of non-discriminatory and market based pricing arrangements for the flexibility product (as set out in the 0116V, 0116BV and 0116VD proposals) would better facilitate objective (b). Under the proposed arrangements, flexibility would be auctioned and allocated to those that value it the most across the shippers and the GDNs. Auctions of flexibility would allow GDNs to compare the true costs of purchasing flexibility with the costs of investing in diurnal storage on their own networks and adopt the most efficient solution. Whilst GDNs currently make similar trade offs in the transitional offtake arrangements, the introduction of flexibility auctions should reveal a market value of flexibility and enhance these trade-offs. We consider this should better facilitate the coordinated efficient and economic operation of the combined pipeline system.

***Objective (c): the efficient discharge of the licensee's obligations***

The Authority considers that the matters relevant to the assessment of the proposals under Objective (c) are effectively addressed through the consideration of the proposals under Objectives (a) and (d). As such, the Authority has not considered Objective (c) further.

***Objective (d): the securing of effective competition between relevant shippers; and or between DN operators and relevant shippers***

The Authority considers that each of the modification proposals, other than 0116A, would better facilitate objective (d) and that modification proposals 0116V, 0116BV and 0116VD would better facilitate objective (d) to a greater extent than 0116CVV. As discussed earlier, the Authority considers that these proposals would reduce the potential for discrimination and therefore promote the securing of competition across a number of areas.

*Flexibility proposals*

In the case of proposals 0116V, 0116BV and 0116VD, the Authority considers that the establishment of equivalent arrangements for shippers and GDNs to access the flexibility product would better secure non-discrimination in the provision of NTS services and better facilitate competition. In particular, under the proposed arrangements, shippers would no longer have unrestricted access to flexibility whilst GDNs were subject to specific restrictions. Each class of user would instead be able to secure capacity under an equivalent framework.

As noted above, the Authority does not accept the arguments put forward by respondents that there are justifiable reasons for different treatment of GDNs and shippers and that

the existing arrangements should continue through the acceptance of proposal 0116A (or alternatively, through 0116CVV).

Respondents have indicated that GDNs are, in contrast to shippers, subject to price control regulation whilst shippers compete in a market. The Authority does not dispute this. However, the Authority does not consider this provides a justification for the two classes of user to be treated differently and for GDNs to be subject to greater restrictions in the use of flexibility compared to shippers. As noted above, for a given load profile both classes of users impose costs on NGG NTS's pipeline system which are invariant to the type of user that they are.

Further, based on the capacity booking framework that was established through the GDN sales process, in booking NTS offtake capacity GDNs are acting, in effect, as agents on behalf of shippers (and ultimately end customers) and are therefore in the same position as shippers acting for TCCs. In addition, the Authority is consulting, through the GDPCR, on incentive mechanisms to encourage GDNs to make commercial trade-offs between the cost of procuring flexibility capacity on the NTS and investing to provide such capacity on their own networks. For these reasons, the Authority does not believe that it is appropriate for the arrangements to discriminate between GDNs and shippers. On this basis, by introducing competition for flexibility rights (between shippers and between GDNs and shippers) through auctions, proposals 0116V, 0116BV and 0116VD would better facilitate the objectives set out in paragraph (d).

#### *Release of flexibility information*

Whilst proposal 0116V provides for the release of certain information relating to the results of the flexibility auctions, the 0116BV proposal provides that NGG NTS should also release certain physical or system operation information regarding the usage of the flexibility product. This includes the publication of information relating to actual utilisation of flexibility on an ex post basis as well as forecast flexibility utilisation. Similar information is also required for publication under 0116CVV as part of the flexibility monitoring regime.

The Authority considers that this aspect of proposal 0116BV would better facilitate objective (d) to a greater extent than the NGG proposal. In particular, the publication of forecast and actual flexibility usage should help to assist market participants in understanding the level of flexibility available on the system from day to day and therefore inform their participation in the auctions.

However, the Authority considers that the beneficial effects on competition associated with the publication of this information would be more than offset by the broadening of flexibility tolerances that 0116BV also proposes and which are discussed above under objective (a). The Authority considers that the broadening of these tolerances would reduce the extent to which users are exposed to the costs of their flexibility usage and could lead to costs being imposed on other users which would not be beneficial to competition.

However, without fettering its discretion in respect of any future decision, the Authority considers that there would be merit in future proposals to increase the transparency associated with forecast and actual usage of flexibility along the lines suggested in proposals 0116BV and 0116CVV.

### *Transfers of flexibility capacity*

As noted above, proposal 0116VD provides for the deadline for notification of transfers of flexibility capacity between zones to be extended from 12:00 to 14:00 hours ahead of the gas day. The Authority considers that there is merit in this aspect of the proposal. In particular, extending the time for flexibility transfers should promote trading and competition between shippers and DNs for the flexibility capacity product and assist in ensuring that it is efficiently allocated amongst network users. As such, this aspect of the proposal should better facilitate objective (d). However, as with the information transparency proposals set out in 0116BV, the Authority considers that these benefits would be more than offset by the broadening of flexibility tolerances which are discussed above under objective (a).

Without fettering its discretion in respect of any future decision, the Authority considers that, for the reasons outlined above, there may be merit in industry participants giving further consideration to extending the period in which flexibility can be transferred.

### *Interruption arrangements*

The Authority considers that proposals 0116V, 0116BV, 0116CVV and 0116VD should all reduce the potential for discrimination in the treatment of interruption. These proposals should remove the risk under the current arrangements that a firm customer that may have triggered investment on the NTS then switches to become interruptible to obtain the benefit of discounted charges. Under this scenario the remaining firm customers (and the shippers representing them) would need to fund investments that they may not have benefited from.

The proposals should also ensure that the discounts provided to shippers in respect of supply points reflect the nature of the services that they receive from NGG NTS. At present and under modification proposal 0116A, the discount payable in respect of supply points is largely unrelated to the frequency or probability of interruption. Indeed, based on existing capacity levels agreed through the TPCR, some customers currently on interruptible contracts appear to face no significant probability of interruption even on peak days experienced once in every 20 years.

The Authority has some concerns that the present interruptible arrangements and those proposed in 0116A may be inconsistent with the European Transmission Access Regulation. However, in assessing the proposals the Authority has not concluded on whether or not this is the case. Indeed, the Authority notes that the requirements in the regulation that interruption is priced on the basis of probability are likely to reflect broader European objectives aimed at ensuring that customers on interruptible contracts genuinely receive a discount in return for accepting a lower level of service than is provided relative to a firm customer.

Nevertheless, the Authority considers that the interruption reforms proposed by 0116V, 0116BV, 0116VD and 0116CVV represent an improvement on the current arrangements in so far as future discounts should genuinely reflect the probability of interruption and would not be provided to supply points that are unlikely to be required for interruption on the 1 in 20 peak day. Further, the arrangements should promote competition as any discounts would be determined on a market basis, with shippers competing to provide interruption and NGG NTS taking the cheapest options available. The Authority notes that some participants have raised concerns regarding the impact of these changes on safety and emergency arrangements. These issues are considered later.

Some respondents, including storage operators, have indicated that the proposed changes in the interruption regime may lead to inefficient investment as customers that are currently interruptible become firm. The Authority does not accept these concerns. First, NGG NTS has obligations under section 9 the Gas Act to develop and maintain an efficient pipeline system. Further, under the regime for future network investment recently agreed through the TPCR process, NGG NTS, before investing, will be required through its licence to investigate alternatives such as the substitution of unused capacity from elsewhere in the network. Indeed, where there are constraints on the network, currently in the south west of the NTS, NGG NTS has been provided with incentives under the TPCR to minimise the costs of contracting for interruption.

#### *Prevailing rights*

As noted above, the Authority has some concerns regarding the introduction of a 'prevailing rights' model. Whilst the proposed regime clearly differentiates between new and existing capacity holders, the Authority nevertheless considers that the 'prevailing rights' framework represents an improvement against the existing baseline represented by the continuation of the transitional offtake regime as proposed in 0116A, as existing users are required to commit to their existing capacity holdings for a longer period. As noted above, this provides the investment benefits outlined under objective (a).

However, for the reasons outlined above, the Authority considers that NGG NTS should monitor the regime to ensure that it does not unduly discriminate against parties particularly if offtake constraints appear or evidence emerges that the framework is leading to distortions of competition between network users.

The Authority does not consider that its decision on prevailing rights for gas offtake necessarily indicates that a similar approach would be appropriate for the allocation of capacity rights more generally across the gas and electricity networks.

#### *Costs of implementation and ongoing operation*

An important consideration for the Authority in its decision has been the weight it should attach to the costs estimates as set out in the Final IA and subsequently revised to include transporter costs (as outlined above).

The costs of implementation of 0116V, 0116BV and 0116VD as reported in the Final IA are potentially significant and, as respondents have noted, could potentially have adverse impacts on entry in the gas sector with detrimental impacts upon competition.

However, the Authority has significant concerns that the continuation of the present flexibility regime as proposed in 0116A and 0116CVV (with a monitoring regime and additional information) would not be appropriate given the risks and uncertainties associated with flexibility constraints occurring in the future. As such, whilst the costs of implementation are potentially significant, in the Authority's view they do not justify the continuation of the existing arrangements for flexibility.

#### *Authority's view against relevant objective (d)*

The Authority considers that proposals 0116V, 0116BV, 0116CVV and 0116VD would all better facilitate the achievement of objective (d).

The Authority considers that 0116V, 0116BV and 0116VD would better facilitate objective (d) to a greater extent than 0116CVV and that 0116V would do so to a greater extent than 0116BV and 0116VD.

The Authority does not consider that 0116A would better facilitate objective (d).

### **Overall assessment against relevant objectives**

**On the basis of the analysis set out above, and considering all of the benefits and detriments of the proposals in the light of the relevant objectives and the statutory duties of the gas transporters as set out in section 9 of the Gas Act, and having had regard to respondents' views, the Authority's conclusions are that:**

- **each of the proposals 0116V, 0116BV, 0116CVV, and 0116VD would better facilitate the achievement of the relevant objectives;**
- **each of the proposals 0116V, 0116BV and 0116VD would better facilitate the relevant objectives to a greater extent than 0116CVV; and**
- **proposal 0116V would do so to a greater extent than 0116BV and 0116VD.**

**The Authority does not consider that 0116A would better facilitate the achievement of the relevant objectives.**

### **Assessment against the Authority's other statutory duties**

In this section, the Authority considers whether the implementation of modification proposal 0116V is consistent with its statutory duties.

#### *Security of supply*

The Authority considers that a framework under which all users provide improved user commitments should provide better information to NGG NTS than is currently the case, thereby improving the planning and investment process and reducing stranded asset risk. Further, the new regime should provide clarity to parties regarding the level of financial commitment they need to make in order to increase their offtake holdings. Better information for NGG NTS and greater clarity to parties seeking to increase offtake holdings should facilitate efficient investment and increase security of supply on the transmission system. As such, the Authority considers that there are security of supply benefits associated with proposals 0116V through the establishment of a user commitment framework.

The Authority does not accept the arguments made by respondents that the requirement for user commitment will have a negative impact on investment by users (e.g. power generators and storage facility developers), with consequent negative implications for security of supply. There is no evidence from the gas entry regime, where capacity rights are sold to users through long term allocations, that this has reduced investment in new gas supplies by users. The entry capacity regime has not prevented in excess of £10bn being invested in over 60bcm of new sources of supply. Companies have also entered into long term commitments to secure capacity at existing entry points, or to underpin investment at new entry points such as Milford Haven.



Some respondents raised specific concerns regarding investment in back up fuel facilities for gas fired generation plant. The Authority notes that the majority of NTS interruptible sites can at present be accommodated on the NTS with firm capacity (i.e. without any investment being required on the NTS)<sup>10</sup>. In this sense, any back up fuel facilities that are owned by these sites would be unlikely ever to be used for network interruption purposes (although they may continue to be useful for market initiated demand side management) and the costs of having these facilities should therefore not be borne by customers generally.

The Authority also considers that the non-discriminatory allocation of the flexibility product across GDNs and shippers under proposals 0116V should have positive security of supply benefits in the electricity sector. As noted above under the present arrangements (and also 0116A and 0116CVV were they to be implemented), there is a risk that constraints could arise in the future as GDNs seek potentially to rely on greater levels of NTS flexibility. This creates the risk that insufficient flexibility will be made available to the market and that some generators may not be able to offtake gas at the rate they desire. In turn this may have negative impacts on electricity market prices. By contrast, we consider that proposal 0116V would enable generators that value flexibility the most to access the capacity on a non-discriminatory basis thereby enabling them to access short term electricity markets when they may otherwise have been prevented from doing so. The Authority considers that the introduction of market based arrangements for the rationing of capacity is preferable from a security of supply perspective (in both the gas and electricity sectors) to the risk that TCCs are arbitrarily denied access to NTS because there is insufficient capacity.

As noted above, some respondents have raised concerns that the proposed flexibility reforms will expose generators to extra costs which may discourage generators from operating. However, the Authority considers that the proposed arrangements set out in 0116V should efficiently target the costs of flexibility usage to those parties that cause these costs (e.g. gas fired power stations). Indeed, by exposing parties to the costs that they cause on the NTS should help to promote undistorted competition between generators in the electricity sector.

### *Safety*

Some respondents have raised concerns that the introduction of reforms to the interruption arrangements (as proposed in 0116V) could, in the event of a Network Gas Supply Emergency, lead to an earlier requirement for firm load shedding under Stage 3 of the Emergency Procedures and thereby undermine safety and reduce continuity of supply to some firm customers.

The Authority has considered the issues relating to safety and believes that the proposed reforms, including those affecting interruption arrangements, are robust and should not diminish safety standards. It is ultimately the responsibility of the network owners to satisfy the HSE on any safety issues that arise. The Authority recognises that development of the NGG NTS and the GDN safety cases will be required and that any revisions to the safety cases must be accepted by the HSE before they can be made. The Authority considers that this requirement should avoid any changes that would diminish safety standards.

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<sup>10</sup> As noted above, there remains some requirement for NGG NTS to contract for interruption in the south west of England.

In relation to the specific issues raised on interruption reform, the Authority considers that it is more appropriate for shippers to contract for interruption services with customers in order to manage market events such as gas supply shortfalls, and that demand side management through the market is the optimal means of preventing emergencies, as opposed to reliance on NGG NTS interruption arrangements which are intended for network capacity management purposes.

The Authority also notes that the arrangements set out in the above proposals do not prevent NGG NTS from contracting for interruption as it considers necessary, including, to ensure the delivery of firm capacity on the 1 in 20 peak day.

In January 2007, the HSE informed the Authority that they had not received from the relevant duty holders an assessment of the safety implications of the proposed changes and it was therefore unlikely that the HSE would be able to advise the Authority on the safety risks of the proposals before the Authority made its decision. The implications of this for the timetable for implementation of the Authority's decision are considered below.

### *Better regulation*

In carrying out its functions under the Gas Act, the Authority must have regard to the principles of better regulation, under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases where action is needed.

An important consideration for the Authority in its assessment of the offtake modification proposals is whether it would be proportionate for it to approve arrangements which involved the introduction of equivalent access arrangements for flexibility.

The Authority's assessment of the proposals under its better regulation duty raises similar issues to those discussed above regarding whether the continuation of the transitional offtake arrangements is unduly discriminatory and whether that discrimination can be justified. In particular, in deciding whether to implement proposal 0116V, the Authority has been required to make a judgement between 0116V and the 0116CVV proposals on the balance between the costs of reform and the practical risk of constraints in the availability of the flexibility product and, in particular, whether the costs of reform are such as to provide an objective justification for continuing discriminatory arrangements in this area.

The Authority considers that the judgements required in determining whether it is proportionate, under its better regulation duties, to require consumers to bear the additional costs involved in proposal 0116V given the uncertainty over the practical risks of constraints are very similar to those made in assessing the discrimination issues.

As noted above, evidence from industry parties presented in Ofgem's Final IA indicates that the costs (which are largely associated with the introduction of flexibility auctions) are potentially significant, although the Authority has some concerns regarding the reliability of the cost data that has been submitted. Further, the 0116V proposal would create more complexity than the 0116CVV proposal which in turn may raise barriers to entry in the wholesale gas sector.

In contrast, evidence on the current availability of flexibility capacity suggests that there is, at present, sufficient capacity available to the market. Under the 0116V proposals, NGG NTS will be required to release 22mcm of flexibility rights per day. Experience to

date is that the maximum level of flexibility utilised on any one day since DN sales is approximately 14-15 mcm. This might suggest that there is currently no need to introduce flexibility auctions.

However, only a short period has passed since GDN sales in June 2005 and there is a risk that over time GDNs may start to become more reliant on NTS flexibility. For example, GDNs, in order to obtain costs savings might consider divestment of gas storage holders which currently provide a source of network flexibility.

The Authority considers that it is difficult to make precise judgements regarding the risks of flexibility constraints occurring in the future. Indeed, there is significant uncertainty on whether constraints will arise.

However, to the extent that constraints do arise, NGG NTS may need to arbitrarily allocate flexibility on an administered basis which may in turn lead to costs to customers. For example, the arbitrary allocation of flexibility may create a risk that a TCC will not be able to take gas against the offtake profile it requires. Ultimately, this could lead to a generator not being able to operate in the electricity market. It is quite possible that such an event could occur at a time when gas and electricity supplies are tight and prices are high. In this instance a failure of a generator to be able to access flexibility could place upwards pressure on electricity prices with significant costs to customers. Under this scenario, the Authority believes there would be a strong possibility that a complaint would be made to the Authority that NGG NTS had discriminated in its allocation of flexibility. Alternatively, the Authority may become involved in a dispute over allocation of rights.

As noted above, the Authority does not consider that the quantitative analysis suggests that the costs of reform are of such a significant magnitude as to provide justification for the continuation of the present arrangements given the risks and uncertainties outlined above.

Further, the Authority considers that the introduction of auction arrangements for the allocation of flexibility amongst shippers and GDNs should reveal the market value of flexibility. This should provide valuable information to market participants which should, in turn, assist them in evaluating the extent to which they devote resources and incur costs in monitoring flexibility and participating in flexibility auctions. To the extent that the auctions do not reveal any constraints going forward, it is possible that the transaction costs incurred by parties to the arrangements will be lower. Conversely, if constraints are present, then these transaction costs are likely to increase as parties increase their monitoring and trading activities.

Whilst the Authority recognises that at present, there is no shortage of flexibility capacity, in view of the uncertainties and risks to customers identified above and the benefits of revealing a market value for flexibility the Authority considers that it would be proportionate to implement O116V.

#### *Compliance with European law*

It is necessary for the Authority to consider whether any of the proposals that have been raised are compliant with European law. As noted above, the Authority considers that whilst the present arrangements appear unduly discriminatory in nature, there are considerable uncertainties in assessing whether the discrimination can be justified. These uncertainties relate to the risks associated with flexibility constraints occurring in

the future and the costs to market participants associated with introducing and operating within a framework for flexibility allocation.

Given these uncertainties, the Authority has not concluded that the existing arrangements are unlawful. The Authority nevertheless considers that, given the risks associated with the potential for flexibility constraints, it would not be appropriate for the existing arrangements to continue indefinitely under either modification proposal 0116A or 0116CVV.

As noted above, the Authority also has some concerns that the present interruptible arrangements and those proposed in 0116A may be inconsistent with the European Transmission Access Regulation, which requires that interruptible capacity products shall be priced on the basis of probability of interruption. However, in assessing the proposals the Authority has not concluded on whether this is the case.

### **Assessment against the Authority's principal objective**

The Authority's principal objective, as set out in section 4AA of the Gas Act, is to protect the interests of consumers in relation to gas conveyed through pipes, wherever appropriate by promoting effective competition between persons engaged in, or in commercial activities connected with, the shipping, transportation or supply of gas so conveyed. In this section, we consider which of the options available to the Authority is best calculated to further the principal objective having regard to the applicable statutory duties.

Having assessed the proposals against the relevant objectives, respondents' views on the proposals and Ofgem's Final IA, the statutory duties of gas transporters, and the Authority's own statutory duties, the Authority considers that modification proposal 0116V best meets the principal objective.

The Authority considers that this proposal should enable NGG NTS to receive long term signals regarding future offtake requirements and thereby reduce the risk of stranded assets, the costs of which are borne by customers in general. The Authority also considers that the proposal reduces the potential for discrimination and therefore should promote competition between different classes of user for the flexibility product and between shippers in the provision of interruptible services to NGG NTS.

The Authority notes that 0116V incorporates a prevailing rights framework. However, for the reasons outlined above, the Authority does not believe that the implementation of a prevailing rights model for gas offtake would, at present, be inconsistent with the Authority's statutory duties. It will, however, be important that this is kept under review by NGG NTS.

### **Other issues raised**

Throughout the consultation process on enduring offtake reform, jurisdictional and industry representatives from Ireland, Northern Ireland and the Isle of Man, have raised concerns regarding the impact of offtake reform on downstream markets in Ireland and Northern Ireland. Under the current offtake arrangements, the majority of Irish and Northern Ireland gas is sourced through the Moffat interconnector which links Ireland with the NTS. The jurisdictions and some market participants have raised concerns that were 0116V to be implemented, GB shippers might purchase and hoard Moffat offtake capacity, thereby preventing downstream participants and new entrants in the Ireland/NI

market from securing capacity and getting access to imported gas. Concerns have also been raised that this may lead to security of supply issues in these jurisdictions.

In response to these concerns, it should be noted that mechanisms are set out within the GB regulatory framework to mitigate the risks that have been identified. These include use-it-or-lose-it provisions for the release of interruptible capacity under proposal 0116V, as well as competition legislation.

Further, as has been outlined in previous Ofgem documents, the Authority's principal objective and statutory duties under the Gas Act concern the gas industry in Great Britain and gas consumers within Great Britain. As such, the Authority's view is that it would not be appropriate for it to take into account the downstream impacts and costs associated with implementation of 0116V on customers in other jurisdictions.

Notwithstanding this, the Authority is keen to assist the Ireland, Isle of Man and NI jurisdictions in addressing the concerns that they have identified. In this respect, the introduction of a single party responsible for all offtake bookings at Moffat going forward is currently being explored. This is discussed further below in the context of the implementation timetable.

### **Implementation timetable**

There are a number of issues that the Authority considers are relevant to the timing of the implementation of 0116V.

#### *Potential improvements to the regime*

In this letter we have identified some elements of the framework established under modification proposal 0116V which may benefit from improvement including the release of information on forecast and actual usage of flexibility and flexibility transfer arrangements.

There may also be other potential improvements and the Authority considers that a delay to the implementation of 0116V will give industry participants additional time to identify these and, should they wish to do so, to raise modification proposals.

#### *Potential Exemption under the Gas Act – Moffat Interconnector*

In order to address the concerns identified by industry participants in the Ireland, Northern Ireland and Isle of Man jurisdictions (as well as by the jurisdictions themselves), it has been suggested that a 'single party' purchaser be established at the Moffat offtake point. This model would allow capacity at the Moffat exit point to be purchased and guaranteed to downstream users over the long term by a single party. However, the creation of the single party purchaser would require an exemption from the DTI under the Gas Act framework. The granting of an exemption requires significant consultation by the DTI and the Authority considers that it is unlikely that any such process would be completed to enable the proposed July 2007 allocations of offtake capacity to take place. On this basis, the Authority considers that a year's delay to the implementation of 0116V is merited to allow further time to resolve the single party issue and the possibility of an exemption from the DTI.

### *Safety cases*

The Health and Safety Executive (HSE) has indicated that reform of the NTS offtake arrangements is likely to require material changes to the NGG NTS and GDN safety cases and that such changes must be accepted by the HSE before they can be made. In January 2007, the HSE informed the Authority that they had not received from the relevant duty holders an assessment of the safety implications of the proposed changes and it was therefore unlikely that the HSE would be able to advise the Authority on the safety risks of the proposals before the Authority made its decision. In view of this, the Authority also considers that a delay of one year in the implementation of 0116V is appropriate to provide more time for HSE consideration of revised safety cases.

**In view of the above factors the Authority recommends that the implementation of modification proposal 0116V is delayed until 1 April 2008. The Authority recognises that a delay to the implementation of enduring offtake arrangements is likely to require further modifications to the UNC in order to establish capacity booking arrangements for the gas year 1 October 2010 to 30 September 2011.**

### **Decision notice**

**In accordance with Standard Special Condition A11 of the Gas Transporters Licence, the Authority, hereby directs that modification proposal UNC 0116V: 'Reform of NTS the offtake arrangements' be made, with a recommended implementation date of 1 April 2008.**

Yours sincerely,

**David Gray**

**Managing Director, Networks**

Signed on behalf of the Authority and authorised for that purpose.