

Modification proposal:	Uniform Network Code (UNC) 154: Enduring provisions for LDZ entry points		
Decision:	The Authority ¹ directs that this proposal be made ²		
Target audience:	The Joint Office, Parties to the UNC and other interested parties		
Date of publication:	28 September 2007	Implementation Date: 1 October 2007	To be confirmed by the Joint Office

Background to the modification proposal

Prior to October 2006, entry points physically connected to the gas distribution network were all deemed to be NTS entry points and subject to the same contractual and regulatory arrangements as those entry points physically connected to the NTS such as St Fergus and Bacton.

It became clear that these arrangements were not an appropriate long term framework for LDZ entry points following requests for connection to the distribution network from new gas storage operators Ineos Chlor and Star Energy.

To address the issue Ofgem undertook a consultation on establishing enduring arrangements for LDZ entry points in 2006³. The outcome of the consultation established a long term commercial and regulatory framework based on a bilateral contractual approach between the entry point and GDN. This approach is designed to facilitate flexible arrangements that take account of the requirements of the entry points and capability of the distribution network.

Enduring arrangements will take effect from 1 October 2007 with the policy being implemented through the introduction in April 2007 of Standard Special condition D12 – *Requirement to offer terms for the provision of gas entry points* - into the GDNs' licence. This places an obligation on the GDN to offer connection terms to a third party wanting to connect and directly enter gas onto the distribution network.

Given that enduring arrangements were not expected to take effect until 1 October 2007, transitional arrangements were implemented on 1 October 2006 to enable Ineos Chlor to commence operations at its Holford storage facility. Modification proposal 105 (UNC105) gave operators entry capacity rights to flow gas onto the network and shippers access to trade at the National Balancing Point (NBP) without the need to deem the entry point to be NTS connected. The transitional arrangements will expire on 1 October 2007 with the expectation that Ineos Chlor will migrate to the enduring arrangements once implemented.

The modification proposal

National Grid Distribution raised Modification Proposal 154 (UNC154) in June 2007. The purpose of the proposal is to provide enduring arrangements for users at LDZ entry points wanting to enter gas directly onto the distribution network. The proposal builds on the concepts and rules introduced by UNC105, albeit on an enduring rather transitional basis. New entry points will be subject to the terms of entry as set out in the bilateral agreements determined between the user at the relevant entry point and the relevant

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

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

³ *Entry arrangements for connecting the gas distribution network*, Decision document – January 2007.

GDN. Existing entry points that are currently allocated baseline NTS entry capacity will migrate to the enduring arrangements in due course.

National Grid Distribution believes that UNC154 will better facilitate the achievement of the relevant objectives of the UNC as follows:

- *Standard Special Condition A11 (1) (a) – the efficient and economic operation of the pipe-line system to which this licence relates:* The proposal that allows for the introduction of gas directly onto a distribution network provides an additional tool for shippers to balance their portfolios. The introduction of new entry capability could therefore facilitate the achievement of this objective;
- *Standard Special Condition A11 (1) (c) – the efficient discharge of the licensee's obligations under this licence:* The proposal will fulfil the obligation placed on each licensee by the direction of SSC D12 in April 2007. The creation of an enduring mechanism in the UNC complements the provisions of this licence condition; and
- *Standard Special Condition A11 (1) (d) - securing of effective competition between shippers and suppliers:* The proposal will deliver an additional source of gas onto the distribution network which will provide an additional tool for shippers to balance their portfolios.

UNC Panel⁴ recommendation

At its meeting of 23 August 2007 the UNC Modification Panel voted not to recommend the implementation of this proposal on the basis of a split vote, with only 5 out of the 10 voting members in favour of its implementation.

The Authority's decision

The Authority has considered the issues raised by the modification proposal and the Final Modification Report (FMR) dated 23 August 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 FMR⁵. The Authority has concluded that:

- 1. implementation of the modification proposal will better facilitate the achievement of the relevant objectives of the UNC⁶; and**
- 2. directing that the modification be made is consistent with the Authority's principal objective and statutory duties⁷.**

Reasons for the Authority's decision

The Joint Office received seven responses to its consultation on UNC154, of which two (including National Grid Distribution) were supportive and three were opposed. A further respondent offered qualified support for the proposal while another did not express a view either way.

⁴ The UNC Panel is established and constituted from time to time pursuant to and in accordance with the UNC Modification Rules

⁵ UNC modification proposals, modification reports and representations can be viewed on the Joint Office of Gas Transporters website at www.gasgovernance.com

⁶ As set out in Standard Special Condition A11(1) of the Gas Transporters Licence, see: http://epr.ofgem.gov.uk/document_fetch.php?documentid=6547

⁷ 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.

In its response, National Grid Distribution considered that UNC154 offered a practical solution via a UNC approved route for those entry points wanting to enter gas onto the distribution network. The satisfactory operation of UNC105, which closely resembles UNC154, was cited as proof that the proposal would provide a workable solution to the issue being addressed.

Although outside the scope of the objectives of the UNC, National Grid Distribution also highlighted the environmental benefits that could accrue from facilitating new sources of gas, such as landfill methane capture, access to the distribution network.

The concerns expressed by respondents opposed to the proposal related mainly to the potential scale of these new entry points and the associated costs that the NTS and NTS shippers might incur. The potential costs identified are as follows:

- **NTS demand forecasting:** the existence of large scale LDZ entry flows could impact on the ability of the NTS to forecast DN off-take flow patterns and profiles. For example, the Offtake Capacity Statement (OCS) booking and planning process may be insufficient to provide the NTS with satisfactory investment signals.
- **Bi-directional flows:** large LDZ entry flows might generate a requirement for gas to flow from the distribution network to the NTS, so that some off-take points become bi-directional. Allocating the costs of turning a DN offtake into a bi-directional system point and assigning responsibility for allocating the flows are yet to be determined.
- **Calorific Value (CV) capping and related shrinkage costs:** large LDZ entry flows of low CV gas which the NTS has no control over could produce significant NTS shrinkage losses. Such costs would be incurred by the NTS and NTS shippers via the balancing incentive, which would result in a misallocation of costs between NTS and distribution network shippers.

Some opponents of the proposal also voiced concerns that the non-transparent nature of the bilateral agreement could be used by GDNs to offer connecting parties terms and conditions that were inequitable and discriminatory. Reservation was also expressed at having different commercial arrangements for entry points connecting to the NTS and the distribution network.

The view of Ofgem as to whether the proposal would better facilitate the relevant objectives is given below:

Standard Special Condition A11 (1) (a) – the efficient and economic operation of the pipe-line system to which this licence relates:

We concur with the proposer and those respondents who stated that the proposal would better facilitate the efficient and economic operation of the GDN's pipe line system. The proposal has the potential to deliver an additional source of gas onto the distribution network by using existing transportation assets at marginal cost. Users will be able to connect to a GDN entry point rather than an NTS one where it considers that it is a more efficient and economic option to do so. As such the proposal should help to promote the use of existing available capacity on the GDNs.

One respondent considered that without a full assessment of the scale and long term impact of the new entry arrangements on the NTS it could not agree that the proposal would lead to an efficient and economic outcome. Other respondents were more forthcoming in expressing the view that the proposal would not facilitate the achievement

of the objective should significant entry flows onto the distribution network cause a negative impact on the ability of the NTS to forecast GDN offtake demand.

Ofgem questions whether the entry of gas onto the distribution network would have such an impact on the ability of the NTS to forecast demand. All available evidence suggests that the scale of affected entry flows will be small. In addition we would expect, that in keeping with the existing terms of the UNC, accurate information regarding nominations and potential flow rates etc, would be supplied to the NTS.

Standard Special Condition A11 (1) (c) – the efficient discharge of the licensee’s obligations under this licence:

We agree with the proposer that UNC154 would facilitate the achievement of this objective. The proposal satisfies the obligation in SSC D12 to offer terms for the provision of entry points wanting to connect directly to the distribution network.

While this view was supported by some opponents of the proposal, they added that UNC154 could compromise the ability of the NTS to efficiently discharge its own licence obligations should the proposal lead to higher costs for both the NTS and NTS shippers. One example cited was the potential for significant NTS shrinkage costs arising from low CV gas entering the distribution network and the impact that this could have on shrinkage costs.

Reconfiguring GDN off-take points into bi-directional ones was also identified as another potential cost that could be picked up by the NTS should the volume of gas supplied by the new entry points prove significant.

Again, we have no evidence to suggest that the volumes of gas expected to enter the distribution network will be sufficient to either trigger flows back onto the NTS or generate high shrinkage losses. For safety and commercial reasons a GDN would be expected, as part of the bilateral agreement, to establish minimum CV requirements. This would go some way to alleviating concerns about high NTS shrinkage losses.

In the event that bi-directional flows were to arise in the future we would expect the NTS to treat such flows in a non-discriminatory manner in line with other bi-directional points located on the NTS. Consistent with their licence obligations to keep their charging methodologies under review, both the NTS and relevant GDN could consider whether amendments to their charging methodologies were required to address bi-directional flows.

Some respondents had concerns that the bilateral nature of agreements could give some scope for GDNs to act in a discriminatory manner. We recognise the importance of GDNs offering equivalent terms to individual entry point, where there are comparable requirements and network capabilities are similar. For this reason, the obligation on GDNs to act in a non-discriminatory manner was incorporated into licence condition SSC D12. The condition also obliges the GDN to make public the principle terms of any agreement within a month of it being made. We are therefore satisfied that the existing licence obligations provide adequate safeguards against potential acts of discrimination.

Standard Special Condition A11 (1) (d) - securing of effective competition between shippers and suppliers:

We agree that the proposal would better achieve this objective by making available additional and alternative sources of gas which would give shippers an additional tool to balance their portfolio. One respondent noted that new sources of gas embedded within a distribution network, such as land fill and mines gas could now be made available to the market.

Opponents of the proposal considered that UNC154 would not secure effective competition between shippers and suppliers. Potentially high shrinkage costs, as previously outlined, could lead to a misallocation of costs between NTS and distribution network shippers. Ofgem, for the reasons previously outlined does not accept that such a risk exists now or is likely to in the foreseeable future.

Summary of Ofgem's view

Ofgem considers that the proposal will facilitate the achievement of the relevant objectives identified by National Grid Distribution. We do not consider that the reasons given in opposition to the proposal are sufficient to prevent its implementation. The available evidence is that the scale of future entry of gas directly onto the distribution network will be small. However, if significant volumes of gas were to emerge then given the lead time required to build an entry facility, the relevant parties should have sufficient time to consider whether to bring forward appropriate amendments to either the UNC or charging methodologies. This would be independent of any review that Ofgem may wish to undertake at a future date.

Decision notice

In accordance with Standard Special Condition A11 of the Gas Transporters Licence, the Authority, hereby directs that modification proposal UNC 154: Enduring provisions for LDZ entry points be made.

Yours sincerely



David Gray

Managing Director, Networks

Signed on behalf of the Authority and authorised for that purpose