

Review of NTS entry charge setting arrangements - Impact assessment

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Overview:

National Grid Gas has brought forward modification proposals to remove the current discounts that are available on short-term firm gas entry capacity products and to restrict the availability of interruptible use-it-or-lose-it entry capacity. The objective of these proposals is to increase the proportion of its allowed revenue that it recovers through entry capacity charges, so that the level and volatility of the commodity charge is reduced.

This Impact Assessment contains our analysis of the proposed modifications against the applicable relevant objectives. Our initial view, subject to consideration of responses, is that the proposals should be vetoed. We consider that gas shippers should be exposed to cost-reflective (marginal cost) charges, and that these proposals would expose shippers who purchase short-term capacity to prices above appropriate marginal costs.

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Context

Further to expressions of concern from users of the National Transmission System (NTS) over the high and variable levels of charges, National Grid Gas (NGG) initiated a review of NTS entry charge setting arrangements. This review has resulted in a charging methodology modification proposal and two Uniform Network Code (UNC) modification proposals all of which have now been submitted to the Authority for decision.

This document sets out Ofgem's impact assessment on these modification proposals along with our provisionally preferred views on the proposals. This impact assessment and its responses will inform the Authority's decisions on whether to veto the charging proposal or approve the implementation of any of the UNC modification proposals put forward.

Associated Documents

- UNC284
- UNC285
- Conclusions report to the Authority: Modification proposals to the gas transmission transportation charging methodology NTS GCM 19R: Removal of NTS daily entry capacity reserve price discounts, 30 April 2010, on National Grid website www.nationalgrid.com
- The Statement of the gas transmission transportation methodology statement: effective from 1 April 2010, on National Grid website www.nationalgrid.com
- Discussion report: Modification proposals to the gas transmission transportation charging methodology & associated UNC and licence issues: NTS GCD08R, NTS entry charging review, 15 March 2010, on National Grid website www.nationalgrid.com
- Modification proposals to the gas transmission transportation methodology statement NTS GCM01 'Alternative methodologies for determination of NTS entry and exit capacity prices', 24 April 2007 (Ref 94/07)
- Pricing consultation paper PC78 - NTS TO Commodity charge (NTS TO under-recovery), 30 July 2004, www.nationalgrid.com
- Pricing consultation paper PC76 - NTS TO entry capacity auction reserve prices and exit charges, 20 DECEMBER 2002, www.nationalgrid.com
- Ofgem decision letter No 0500 'Long term capacity allocation', 30 September 2002, Joint Office website www.gasgovernance.co.uk
- Transco's national transmission system: System operator incentives 2002-7: Final Proposals, 14 December 2001, (Ref 77/01)
- Modification Proposal 0630 'Zero reserve price for within-day sale of daily system entry capacity', 19 October 2006, Joint Office website www.gasgovernance.co.uk

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Summary

Background

Gas shippers who want to bring gas onto the National Transmission System (NTS) have to purchase the appropriate volumes of gas entry capacity from National Grid Gas (NGG). Entry capacity is sold through a series of auctions spanning a range of time periods; from 3 month blocks up to 17 years ahead, right down to on-the-day sales. Capacity offered through the longer-term auctions has a non-zero reserve price, whereas on-the-day capacity has a zero reserve price.

NGG recovers the entry portion of its allowed revenue through Transmission Owner (TO) entry capacity and commodity charges. NGG receives revenue for capacity through the capacity auctions; the commodity element of revenue is derived from a volume-based charge which seeks to ensure that NGG achieves its allowed revenue, should there be a shortfall in the capacity revenue (relative to the allowed revenue).

In recent years, the commodity element of the revenue recovered by NGG has been growing, such that it currently constitutes the majority portion of the recovered revenue. Some shippers have expressed concern about the level and volatility of the commodity charge. NGG instigated a review of the charging arrangements to see if an alternative charging scheme which would address these concerns could be devised.

Modification proposals

Following consultation with industry, NGG has proposed a charging modification (GCM19) which seeks to set the reserve price for short-term firm capacity auctions at the same level as that for longer-term auctions. It has also proposed two Uniform Network Code (UNC) modifications; one (UNC284), which is an enabling modification for GCM19, and another (UNC285), which seeks to limit the availability of Use-It-Or-Lose-It (UIOLI) capacity. The concern is that without UNC285, the intent of GCM19 would be undermined by the availability of UIOLI capacity at below reserve price.

The review group also considered two further developments might be necessary; first, that revenues from on-the-day sales should be transferred from the System Operator (SO) allowance to the TO revenue allowance; and second, that in due course, multipliers might be applied to short-term reserve prices in order to incentivise long-term capacity bookings. Whereas these have not been developed further, we have included consideration of the first of these in our assessment as it would be required imminently if GCM19 was not vetoed.

Ofgem's initial view

Having considered the analysis underpinning the proposal, our initial view is that the proposals do not address the concerns of the level or volatility of the TO commodity charge. The likely impact on level of charge is a small percentage, and the

uncertainty of the effect of the proposals may contribute to charge volatility. Furthermore, Ofgem considers that the capacity reserve prices should be based on the marginal cost of providing the capacity. The basis for marginal cost pricing is that if shippers are confronted with paying the marginal cost for an extra unit of capacity then they will only agree to pay this where their marginal benefit from the extra capacity is greater than or equal to the marginal cost. This is expected to result in the more efficient allocation of resources, to the benefit of consumers.

We consider that the imposition of reserve prices that are above the marginal cost of providing that capacity may artificially limit the availability of capacity. Those users who place a low value on capacity and so only book it in the short-term auctions are still contributing to the system operating costs through the commodity charge, but they run the risk that in times of high system load and high gas prices they might be constrained off the system. Reserving capacity in advance provides users with the certainty that the capacity will be available when they need it, and the premium such users place on this certainty is reflected in the reserve price.

Next steps

Our provisional opinion, subject to responses, is to veto GCM19 and reject the associated UNC proposals (UNC284 and UNC285). We are seeking views on the content of this impact assessment by 22 July 2010, in order to inform the Authority's final decisions on the various proposals. Due to the time-limited nature of the charging modification process, we expect to have issued an Authority decision on GCM19 by 30 July 2010. We anticipate that the decisions on the related UNC modification proposals will be issued concurrent with the charging modification decision.

1. Background

Chapter Summary

This chapter sets out the background to the issues in this impact assessment. This includes a summary of the operation and use of the gas transmission system in the UK, the National Transmission System (NTS); how the owner and operator of the NTS, National Grid Gas (NGG), recovers revenue from users of the NTS; how users access the NTS for entering gas onto the network and the charges they pay.

This chapter also provides a brief history of developments in the gas transmission entry regime and Ofgem's thoughts on these developments at the time. We then introduce the perceived deficiencies in the current entry charging arrangements which resulted in NGG initiating a review of these. Finally, we set out the legal framework under which Ofgem assesses any proposals to modify the charging methodology and Uniform Network Code (UNC).

Background

1.1. NGG owns and operates the high pressure gas transmission network in the UK, the National Transmission System (NTS). Shippers bring gas onto the NTS either from gas fields, via interconnectors and Liquefied Natural Gas (LNG) import terminals or from storage. The gas can then be delivered direct to Transmission Connected Customers (TCCs) or for further delivery across the low pressure Gas Distribution Networks (GDNs) and Independent Gas Transporters (IGTs) to final consumers.

Current arrangements

Entry capacity auctions

1.2. In order to use the NTS, shippers must first buy entry capacity, to flow gas onto the NTS, and/or exit capacity, to take gas off the NTS. If shippers do not buy sufficient capacity for the actual amounts of gas they flow, they will incur overrun charges, as set out in the Uniform Network Code¹ (UNC). NGG is obliged to offer for sale certain amounts of baseline entry capacity at each entry point, i.e. 'baselines'. NGG sells baseline entry capacity via the following firm products:

- Quarterly System Entry Capacity (QSEC) – this allows the holder rights to flow gas onto the NTS up to the amount held each day for a three month period
- Monthly System Entry Capacity (MSEC) – this allows the holder rights to flow gas onto the NTS up to the amount held each day in a calendar month

¹ A copy of the UNC can be found on the website of the Joint Office of Gas Transporters i.e. <http://www.gasgovernance.com/>

- Daily System Entry Capacity (DSEC) - this allows the holder rights to flow gas onto the NTS up to the amount held for a single day

1.3. NGG sells these products through a series of auctions as listed below:

- Quarterly System Entry Capacity (QSEC) auctions – these auctions run annually (in March) and offer for sale unsold baseline capacity² in the quarterly blocks from between 2 and 17 gas years in advance. All shippers pay the same ‘clearing price’ for capacity at a particular entry point and quarter. Only in these auctions can incremental obligated entry capacity³ be released above baseline. This happens if the net present value of the revenue from the bids is greater than or equal to 50 per cent of the estimated project value for making the capacity available.
- Annual Monthly System Entry Capacity (AMSEC) auctions – these auctions run annually (in February) and offer all unsold baseline capacity in monthly blocks for up to 18 months in advance. This is a pay-as-bid auction.
- Rolling Monthly Transfer and Trade System Entry Capacity (RMTTSEC) auctions – these auctions run monthly and offer all unsold baseline capacity (and any capacity surrendered by shippers for resale) in monthly blocks one month in advance. This is a pay-as-bid auction.
- Day Ahead Daily System Entry Capacity (DADSEC) auctions - these auctions run daily and offer all unsold baseline capacity as daily blocks one day in advance. This is a pay-as-bid auction.
- Within Day Daily System Entry Capacity (WDDSEC) auctions – these auctions run daily and offer all unsold baseline as daily blocks for use on that day. This is a pay-as-bid auction.

1.4. In addition to the firm capacity products NGG also offers Daily Interruptible System Entry Capacity (DISEC) which allows the holder rights to flow gas onto the NTS up to the amount held for a single day, subject to NGG not interrupting the flows. DISEC is allocated via DISEC auctions which are held each day in advance of the gas flow day. These are pay-as-bid auctions. Under UNC provisions NGG is required to offer the Use-It-Or-Lose-It (UIOLI) amount of capacity in the DISEC auctions. The UIOLI amount of capacity is the average unused capacity (firm capacity sold minus the proportion of that capacity used to flow gas) over the previous 30 days.

1.5. NGG can release discretionary amounts of firm and interruptible capacity in addition to both its firm obligations (both baseline and incremental) and the UIOLI amount and is incentivised to do so.

1.6. The table in Appendix 2 sets out the key changes to the gas transmission entry regime which have led to establishment of the current regime.

² 10% of baseline capacity is held back for shorter term auctions.

³ Incremental obligated entry capacity is additional capacity that NGG is obliged to make available above its baseline (or non-incremental) entry capacity obligations.

Revenue arrangements

1.7. In the review of Transco's TO price control, covering the period 2002-2007, Ofgem split the regulation of the NTS into two main roles: Transmission Owner (TO) - to build and maintain the network; and, System Operator (SO) - to determine the need for incremental NTS capacity and operating the system day to day.

1.8. NGG's NTS licence sets out the amount of Transportation Owner (TO) and System Operator (SO) revenues that it is allowed to collect.

TO Allowed Revenue

1.9. The TO allowed revenue is collected equally between entry and exit users of the NTS (after deducting metering and Distribution Network (DN) pensions related revenue). Therefore, 50 per cent of the TO allowed revenue is collected through entry charges – referred to here as TO entry allowed revenue. This revenue is recovered through two distinct charges: entry capacity charges and entry commodity charges.

1.10. NGG collects TO entry capacity charges by auctions of NTS entry capacity across various time periods, ranging from 17 years ahead to day-ahead (revenues from on-the-day capacity sales go to the SO revenue pot). However, revenue from the sales of entry capacity at auctions does not in practice equate to 50 per cent of the TO allowed revenue. Therefore, there are mechanisms in place should NGG under- or over-recover through auctions.

1.11. Any shortfall in auction revenue against the TO entry allowed revenue is collected via a TO entry commodity charge. This is a per unit charge based on the volume of gas flowed by shippers at entry points, but it does not apply to storage entry points or short-haul allocations⁴. If there is still revenue under-recovery at the end of the year then the revenue shortfall is added to the following year's TO entry allowed revenue (via the entry K factor⁵).

System Operator (SO)

1.12. The SO maximum allowed revenue is made up from a number of incentives including those on entry and exit, and is collected via a number of charges:

⁴ An optional 'short-haul' tariff was made available to users in lieu of paying the TO and SO commodity charges. The rationale was that the short-haul tariff reflects more accurately the costs of transporting gas from large entry terminals to nearby exit points. It was argued that this removes the perverse incentive for the construction of independent pipelines and thus avoiding NTS charges, which could be inefficient outcome for all NTS users. Short-haul allocations are the flows of gas between entry and exit points where users have opted to pay the 'short-haul' tariff.

⁵ See term TOK_i described in Special Condition C8B(3)(a) of NGG's gas transporter licence in respect of the NTS.

- RCOMt - these are charges other than those listed below: mainly SO entry and exit commodity charges; payments by NGG in reducing costs arising from SO activities e.g. net payments to users through capacity neutrality mechanisms⁶.
- Exit charges - this mainly relates to incremental exit capacity charges
- Entry charges - this relates to revenue from:
 - on-the-day sales of baseline capacity⁷
 - sales of new firm entry capacity⁸
 - sales of discretionary firm capacity⁹
 - sales of interruptible entry capacity
- other - including balancing neutrality charges, overrun charges, failure to interrupt charges and revenue from locational sell actions and physical renomination incentive charges

Entry capacity charging

1.13. The auctions have a minimum, or reserve, price which bids must equal or exceed in order to be allocated capacity. This reserve price is calculated by application of the gas transmission transportation charging methodology. The charging methodology effectively calculates the Long Run Marginal Cost (LRMC) at each entry point and makes some adjustments¹⁰. The reserve price for a day's worth of entry capacity is equal to 1/365th of the annuitised and adjusted LRMC.

1.14. NGG has a licence obligation¹¹ to use all reasonable endeavours to offer for sale all unsold obligated¹² entry capacity at each entry point in at least one 'clearing allocation', unless otherwise directed by the Authority. The licence defines a 'clearing allocation' as: an allocation of entry capacity which results in all capacity offered for sale being sold; or, an allocation which has a zero reserve price.

1.15. To comply with this clearing allocation obligation, NGG offers discounts at auctions for daily capacity products, as follows:

- Day ahead (DADSEC) auction – 33.3% discount on the reserve price
- Within day (WDDSEC) auction – 100% discount on the reserve price i.e. a zero reserve price

⁶ The capacity neutrality mechanism works such that NGG does not gain or lose from a number of means to maximise capacity made available on the NTS and any congestion management that it may be required to take as a result of maximising the capacity made available.

⁷ Baseline capacity is the amount of capacity that NGG is obliged to make available at each entry point. The amounts are specified in Special Condition C8D(9)(c)(iii) of NGG's NTS licence. In the licence it is termed 'non-incremental obligated entry capacity'.

⁸ This is given the term 'incremental obligated entry capacity' in NGG's NTS licence.

⁹ This is given the 'non-obligated incremental entry capacity' in NGG's NTS licence.

¹⁰ These include adjustments so that a 50:50 split between entry and exit is maintained, annuitisation, and that a minimum reserve price of 0.0001 p/kWh/day is applied to avoid negative reserve prices

¹¹ See Special Condition C8D(9)(e).

¹² Obligated includes non-incremental obligated entry capacity, 'baseline', plus any incremental obligated entry capacity triggered through the QSEC auction.

1.16. At the auctions for daily interruptible entry capacity the reserve price is also set at zero. Shippers pay the price at which capacity is allocated for all auctions of entry capacity; the price is not adjusted for inflation if bought in previous years.

Development of gas transmission entry regime

Key developments

1.17. The floor price for daily capacity has reduced relative to other products since 1998 when it was four times the daily rate implied from annual capacity charges. It was subsequently reduced in 1999 and again in 2000. When QSEC auctions were introduced in 2002, the reserve price for day ahead capacity was set at two-thirds that of the monthly capacity reserve price¹³ and the reserve price for within day capacity was set at zero.

Reserve prices and long-term auctions

1.18. In the decision on modification 0630¹⁴, which set the reserve price for within-day auctions at zero in the network code, and the decision on PC76¹⁵, which set the reserve price for quarterly, monthly, day-ahead and within day auctions at their current relativities, Ofgem set out its views, at that time, on reserve prices.

1.19. The above decisions noted that Ofgem had consistently stated that reserve prices were only necessary to address competition concerns. These concerns were that at entry points with a limited number of players, shippers could secure long term capacity allocations at zero or low prices, which does not reflect the value they place on the capacity. In the short term auctions Ofgem considered there to be sufficient competition at the majority of large beach terminals to avoid significant under-recovery. Ofgem also noted that some floor price was needed for triggering incremental entry capacity.

1.20. Ofgem also stated its concerns with reserve prices, these were that they could:

- prevent price discovery at competitive terminals
- inhibit competition for capacity between terminals by application of differential reserve prices at different entry points
- prevent all capacity from being released to the market
- prevent the market from clearing, if entry capacity only sells at the reserve price or above

¹³ This maintained the relativity to MSEC reserve prices. MSEC reserve prices had previously received a 25 per cent discount on the established LRM methodology whilst DSEC reserve prices had a 50 per cent discount. Once the QSEC auction was established the MSEC reserve price was set at the same level as the QSEC reserve price. In order to maintain the relativity of DADSEC reserve prices with MSEC reserve prices, DADSEC prices were given a 33.3 per cent discount on QSEC reserve prices.

¹⁴ See the Joint Office website www.gasgovernance.co.uk

¹⁵ See National Grid website www.nationalgrid.com

1.21. Ofgem considered that a zero reserve price for within day capacity auctions would: enable the market for entry capacity to clear; allow the market to determine the price for capacity at each terminal; and, remove the price differential between entry points on the day, which should facilitate competition between entry points.

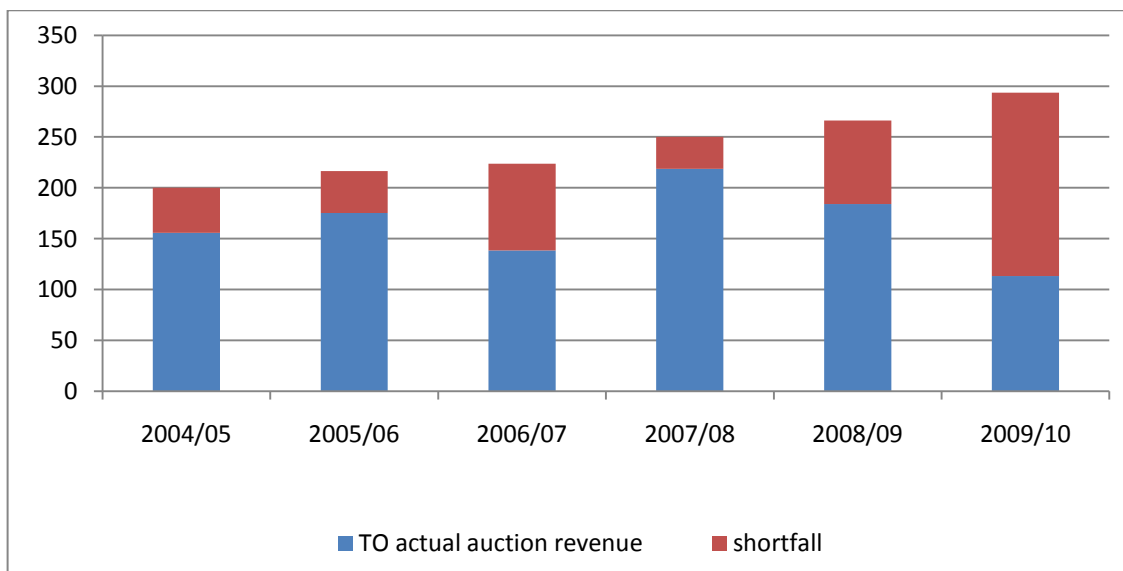
1.22. In the decision on modification proposal 0500¹⁶ Ofgem set out its views on long-term auctions, these were that they would:

- Bring about substantial improvements to the NTS investment planning process, in combination with the entry capacity incentive¹⁷
- Provide reliable indication of the demand for entry capacity at different locations on the NTS
- Provide reliable and robust signals to inform investment decisions
- Provide increased certainty over entry capacity charges over the long term

Perceived deficiencies in current arrangements

1.23. Initial experiences of auctions from 1998 to 2002 resulted in significant revenue over-recovery. In general, since 2002, auction revenues have increasingly under recovered in relation to the TO entry allowed revenue. However, there was a large swing to recovering more revenue via auctions in 2007/8 as a result of capacity constraints at Easington, see figure 1.1.

Figure 1.1: TO allowed revenue showing auction revenue and shortfall (£ million)

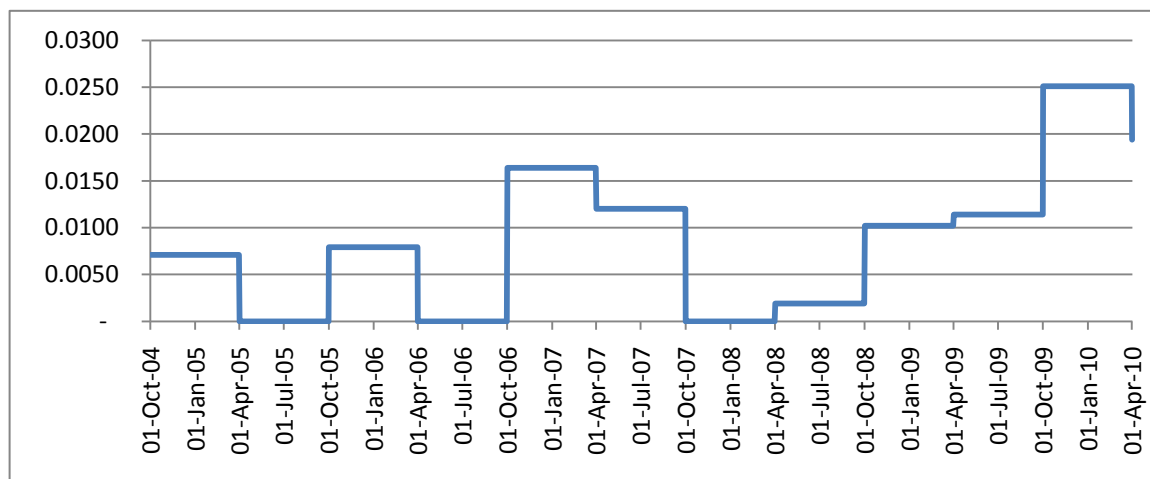


¹⁶ See 'Ofgem Decision Letter No. 0500 "Long Term Capacity Allocation"' dated 30 September 2002, on the Joint Office website www.gasgovernance.co.uk

¹⁷ The entry capacity incentive refers to incentives on Transco (as NGG was formerly known) to invest in NTS entry capacity where it is efficient to do so. These incentives included potentially higher rates of return for additional entry capacity made available compared to that for existing entry capacity.

1.24. As a result of the auction under-recovery, the TO entry commodity charge was introduced in 2004 to recover any shortfall in TO entry allowed revenues from auctions. The general decline in auction revenues since 2002 has led to increasing TO entry commodity charge rates (both level and inter-year volatility -see figure 1.2).

Figure 1.2: TO entry commodity charge (p/kWh)



1.25. This has caused concern amongst shippers and NGG over price predictability, cross-subsidies and a lack of long-term signals from the existing regime. In September 2009 NGG initiated a review NTS entry charge setting arrangements to determine whether they are still appropriate and consistent with the relevant charging methodology objectives.

Review aims

1.26. As part of developing the Terms of Reference (ToR) for the review of NTS entry charge setting the review group agreed on a number of issues to be considered in addition to the statutory, licence and European considerations.

1.27. These were that the review should identify any charging methodology and/or UNC modifications required to:

- Continue to recover allowed revenue while achieving the NTS Licence and EU relevant charging objectives
- Maximise the proportion of the NTS TO target entry revenue recovered through entry capacity charges
- Appropriately incentivise long term booking of NTS entry capacity
- Appropriately differentiate by price between the NTS capacity products made available
- Incentivise security of supply

1.28. These are mainly captured through the various statutory duties and licence obligations. Therefore we will assess the proposals, as required, against the relevant objectives, statutory duties and requirements including the requirement to ensure compliance with European law, against the background of the review group's aims.

Legal framework

1.29. The Gas Act 1986 (the "Act"), and amendments to it, sets out the main statutory framework under which the gas industry operates including the principal objective and general duties of the Authority. Other relevant statutory instruments are detailed in paragraph 1.2 of Appendix 9.

1.30. In addition to the regulatory framework set out under the Act, the gas industry is also subject to European and competition law. Appendices 9 and 10 set out the legal framework in greater detail.

Licence obligations

1.31. National Grid Gas's (NGG) gas transporter licence sets out the relevant objectives with which the gas transmission transportation methodology and the Uniform Network Code (UNC) must conform.

1.32. In making its decision whether or not to allow the proposed charging methodology and UNC modifications the Authority will first consider whether the proposals facilitate the achievement of the relevant licence objectives. The objectives for the charging methodology and the UNC are set out in Appendix 6.

1.33. The charging methodology objectives relate to cost reflectivity, accounting for industry developments and facilitating competition. Also where charges are set by auction either no reserve price is set or it is set to promote efficiency, avoid undue preference and promote competition.

1.34. The UNC objectives relate to efficient and economic operation of the National Transmission System (NTS), co-ordinated, efficient and economic operation of various pipe systems, efficient discharge of NTS licence obligations, securing effective competition and providing incentives for suppliers to secure supply security standards.

2. Proposals

Chapter Summary

This chapter summarises the proposals that have come from the review of NTS entry charge setting arrangements. These proposals are:

- ➔ GCM19: to remove the discounts on the reserve price for firm daily entry capacity
- ➔ UNC284: to remove the zero reserve price for on-the-day sales of firm entry capacity (this helps facilitate part of GCM19)
- ➔ UNC285: to restrict the release of Use-It-Or-Lose-It (UIOLI) interruptible entry capacity to when less than or equal to 10 per cent of firm entry capacity remains unsold after the rolling monthly auctions

In addition to the proposals that have been submitted to the Authority for decision the review group came up with additional ideas which have not yet been issued for consultation. We also summarise these here and review one of these as part of the impact assessment, this being the proposal for the reallocation of revenue from on-the-day sales - so that the revenue from on-the-day sales of baseline capacity is no longer redistributed via the capacity neutrality mechanism and that it contributes to the TO revenues and not SO revenues.

Questions

There are no questions on this chapter.

Review of NTS entry charge setting arrangements

2.1. A review of NTS entry charge setting arrangements was initiated by NGG in September 2009 amid concerns over high and volatile TO entry commodity charges. The review group looked at a number of potential factors which may be causing low auction revenues. Three key sources were identified as:

- Price paid: one source of under-recovery results from the reserve price discounts for daily capacity bought day-ahead and on-the-day.
- Model changes: The second source identified was the replacement of the previous network model (Transcost) with the Transportation model, in 2007¹⁸. Prices based on Transcost were generally lower than those set via the Transportation model. As capacity can be bought up to 17 years in advance at long-term auctions the lower prices set via Transcost will be important for a number of years to come.
- Peak amount of capacity procured: NGG noted that if capacity was procured at prevailing reserve prices up to the forecast level of supply published in the Ten

¹⁸ See Ofgem decision on GCM01 'Alternative methodologies for determination of NTS entry and exit capacity prices', which was published on 24 April 2007 with reference number 94/07. GCM01 implemented the Transportation model with effect from 1 October 2007.

Year Statement (TYS)¹⁹ then NGG would over-recover its TO entry allowed revenue. However, shippers do not book capacity up to this level ahead of the gas day, i.e. before the reserve price is set at zero. Shippers can also profile their capacity holdings in the long-term auctions, so they don't have to overbuy capacity.

2.2. The review group considered a number of potential options to deal with the high and volatile TO entry commodity charges, most of which it rejected on various grounds.

2.3. One option considered was to apply a reduced TO entry commodity charge rate to entry capacity which was booked through the long-term auctions. This would result in higher TO entry commodity charges for short-term capacity purchases. The review group discarded this option as NGG considered that it would incur significant system impacts and costs.

2.4. The review group also considered varying the 50:50 split between recovering TO allowed revenue from entry and exit such that more would be recovered from administered exit charges. The review group rejected this as it considered that this would be detrimental to cost reflectivity.

2.5. Another potential option discussed was to revise the capacity products that are available (such as replacing the quarterly product with an annual product and/or replacing the annual auction of monthly capacity with an auction of quarterly product). This option was discarded, as work currently underway at the European level on capacity allocation mechanisms may require further changes in this area and it was considered prudent to await the outcome of this European work before considering changes that might be appropriate in GB.

2.6. The review group, following consultation²⁰, favoured the development of proposals to increase TO entry auction revenue recovery; these propose to:

- remove firm capacity discounts - the group considered that this would result in more revenue from day-ahead auctions of daily entry capacity and so reduce the shortfall in revenue to be recovered via the TO entry commodity charge. However, it was considered that this would not resolve the issue of high and volatile TO entry commodity charges by itself.
- only release interruptible capacity when firm has sold out - as this would remove the potential for shippers to acquire interruptible capacity at zero reserve price when firm capacity remained unsold, which would otherwise undermine attempts to boost revenue recovery from removing the discounts.

¹⁹ The Ten Year Statement (TYS) is published by NGG annually. It sets out the forecast of NTS usage and likely developments on the NTS.

²⁰ See 'Discussion Document, Modification proposal to the Gas Transmission Transportation Charging Methodology & Associated UNC and Licence Issues: NTS GCD08, NTS Entry Charging Review', published on 18 January 2010 on NGG's website www.nationalgrid.co.uk

2.7. The review group, and respondents to the consultation, considered there were arguments both for and against each of these proposals. These are outlined further in Chapter 3.

2.8. The review group considered these proposals as the first phase of work: if implemented, the group would consider the possibility of daily and monthly capacity reserve price multipliers. This would allow for an assessment of the first phase against the group Terms of Reference, so the need for further changes could be assessed.

GCM19

2.9. On 30 April 2010 NGG submitted its final report for modification proposal GCM19, 'Removal of NTS Daily Entry Capacity Reserve Price Discounts'.

2.10. This proposal would remove the discounts on the reserve prices for the daily capacity (both day-ahead and within day) auctions such that the reserve prices for daily capacity auctions would be equal to the reserve price in the monthly auctions.

2.11. NGG proposes that if GCM19 is to be implemented that it be effective for capacity made available from 1 October 2010. In order to facilitate the implementation of GCM19 NGG consider it would be necessary to make associated changes both to the UNC and to NGG's licence. These associated changes are described below.

Changes to the UNC

2.12. In order to facilitate GCM19, NGG raised two UNC modification proposals.

2.13. Modification proposal UNC284, 'Removal of the zero auction reserve price for within-day daily NTS entry capacity (WDDSEC)'. The Final Modification Report was published on 24 May 2010. UNC284 removes reference to the zero reserve price for daily capacity auctions. NGG proposes that UNC284 be implemented for capacity made available from 1 October 2010.

2.14. NGG considers that if the discounts are removed from the daily capacity products then shippers may continue to buy interruptible capacity made available through the UIOLI mechanisms at little or no charge. NGG considers that this could undermine the attempts to increase revenue from capacity auctions through GCM19. Therefore the review also considered proposals to amend the arrangements for the release of UIOLI interruptible capacity. NGG raised UNC285, "'Use it or lose it" (UIOLI) Interruptible capacity only to be released when there is at most 10% unsold firm entry capacity'. The Final Modification Report was published on 28 May 2010.

2.15. UNC285 proposes that NGG only releases UIOLI capacity at an entry point when there is at most 10 per cent of entry capacity remaining unsold following the

monthly auctions (and so prior to the day-ahead auctions). Specifically, UIOLI will only be released when the unsold ratio is less than or equal to 10 per cent. The unsold ratio equals:

- $A/(B+C)$, or
- Zero where $(B+C)$ equals zero i.e. at new entry points where no incremental entry capacity has been triggered.

Where:

A = unsold entry capacity

B = non-incremental obligated entry capacity i.e. baseline

C = incremental obligated entry capacity

2.16. The proposal stresses that there would be no change to the ability of NGG to release discretionary interruptible capacity in addition to the UNC required UIOLI amount. Furthermore, the reserve price for daily interruptible capacity would remain at zero.

2.17. NGG proposes that UNC285 be implemented for capacity made available for 1 October 2010.

UNC295

2.18. Following concern from some shippers that GCM19, UNC284 and UNC285 may result in reduced availability of on-the-day entry capacity, E.On raised modification proposal UNC295 'Allocation of daily NTS entry capacity within-day'.

2.19. This aims for clarity regarding when NGG undertakes a capacity allocation period on-the-day. E.On considers that strict interpretation of the current rules suggests that NGG only has to initiate one capacity allocation period on-the-day. UNC295 proposes that when a capacity bid is received on-the-day NGG must initiate a capacity allocation period at the next hour bar. E.On considers that this provides shippers with greater certainty that their bids for capacity on-the-day will receive sufficient consideration by NGG.

2.20. The consultation for this closed on 7 June 2010.

2.21. Whereas there are links with UNC295 and the proposals under consideration in this IA, we consider that UNC295 can be considered in its own right, independent of the outcome of this IA.

Potential licence changes

2.22. In the submission of the final report for GCM19, NGG noted another potential proposal that had been discussed during the review.

2.23. This would be to treat revenue from the within-day sale of baseline entry capacity:

- As TO revenue, and not as SO revenue as is currently the case - this would require a licence modification and implies removing this revenue contribution from the buy-back incentive
- Such that it is not redistributed via the capacity neutrality scheme - this would require a UNC modification

2.24. There have not been any UNC or licence modification proposals raised to implement such a proposal; however, we also consider this as a potential proposal for the purposes of examining its impact.

Options

2.25. The various proposals to modify the UNC, charging methodology and licence allow for a number of different permutations to create options which we consult on as part of this impact assessment.

2.26. As UNC284 is merely a facilitating mod for implementation of GCM19 we consider that it is included in GCM19 for the purposes of developing the options. As UNC295 is still in the developmental stages we do not explore its combination with other proposals here.

2.27. This therefore gives three main proposals:

- GCM19 (plus UNC284)
- UNC285
- Reallocation of revenue from on-the-day sales of baseline entry capacity (referred to as "Proposal 3" in this document)

2.28. These three main proposals combine to give eight possible outcomes; reject/veto all, approve/not veto all and all variants in between. We explore the impacts of these variants in Chapter 5.

3. Industry views on proposals

Chapter summary

This chapter gives industry views on each proposal along with a review of NGG's estimate of the impacts on auction revenues. A more complete review of industry responses to the consultation processes preceding this IA is given in Appendix 3.

Questions

Question 1: Do you agree with NGG's analysis on the impacts of removing the reserve price discounts?

GCM19

3.1. GCM19 proposes removing reserve price discounts at firm daily entry capacity auctions such that the reserve price would be equal to that in the monthly auctions.

3.2. NGG undertook analysis on the impact of removing discounts for auction revenues in 2008/9. Sales of discounted capacity generated revenue of £1.2 million. NGG calculated that the revenue from the sales of the discounted products would have been £135 million, if it had been able to be sold at reserve price.

3.3. To assess the impact of the proposal, NGG consider two assessments of the impact on auction revenue:

- In the first assessment, NGG assumed that shippers would be able to trade capacity between themselves in order to match their capacity holdings to their flow requirements. NGG compared long-term capacity bookings against actual capacity requirements across the system and calculated the additional interruptible capacity that would be needed to perfectly match flow requirements. NGG then applied the monthly reserve price to this capacity to estimate the additional revenue that would have been recovered, which gave a figure of £3 million.
- In the second assessment, NGG assumed that shippers cannot trade capacity on the secondary market. NGG took the difference between individual shipper monthly capacity holdings and their actual flow requirements at each entry point. This suggested an additional revenue recovery of £71 million.

3.4. On the basis of this analysis, NGG considers the potential change in TO entry capacity revenue from removal of discounts in daily and interruptible auction revenue is between £3 million and £71 million. NGG considers that the initial impact will be at the higher level but this will reduce as a secondary market develops.

Industry views in relation to the charging methodology objectives

Promoting efficiency and avoiding undue preference

3.5. The review group considered that, as reflected in GMC19, daily users should pay 1/365th of the annuitised long-run marginal cost. It argued that having a zero reserve price gives undue preference to those shippers booking short-term capacity and considered that it would encourage more long-term bookings if users could no longer acquire capacity for free or low cost in the short-term. Long-term bookings were considered to facilitate better planning of an efficient NTS and reduce the potential for short-term congestion resulting from lack of long-term signals.

3.6. NGG noted in its report that the current situation of discounted reserve prices in the short-term are attractive when capacity is considered to be in plentiful supply but that this discourages signals for long-term investment. It considered that this can result in capacity scarcity, such as that at Easington in 2007, which leads to high and unpredictable capacity prices (see Appendix 4 for more details). It therefore considered that the reserve prices were not being set at levels to promote efficiency.

Competition

3.7. Some respondents to NGG's consultation noted that the removal of reserve price discounts should increase auction revenues and consequently reduce the TO entry commodity reserve price. They considered that this improves price predictability and the attractiveness of the GB market which should promote competition.

3.8. Others noted that without modifications to the treatment of revenue from sales of on-the-day capacity (ie the switch of on-the-day capacity sales revenues from the SO to the TO), GCM19 would have little impact on TO revenue recovery.

3.9. One respondent thought that GCM19 would reduce gas market liquidity if traders were discouraged from short term trades because the volume of short term physical capacity was reduced. This reduced liquidity would be detrimental to competition in the market for gas.

3.10. A number of respondents considered that shippers booking in the medium to long term, which do not receive discounts, cross subsidise shippers booking in the short-term auctions. This is because medium to long term bookings face a higher reserve price, but still pay the same commodity charge. Others consider that shippers at new entry points are disadvantaged from not having access to short term discounts and that there is some undue preference towards shippers at existing entry points. This undue preference would have implications for competition.

Cost reflectivity

3.11. One of the relevant objectives require prices not set via auction to be cost reflective. As the capacity prices are set via auction then this objective is not

applicable to them per se. However, NGG considers that since the commodity charge is a charge derived from allowed and auction revenues, it is also not cost reflective.

Developments in transportation business

3.12. One respondent suggested that implementation of GCM19 would add to regulatory uncertainty at a time when Ofgem's Project Discovery had identified the need for significant investment to meet security of supply concerns. Another respondent commented that GCM19 might address EU developments for common principles for congestion management procedures at interconnector points. However, these guidelines have not been finalised.

UNC284

3.13. UNC284 would facilitate the implementation of GCM19 by removing UNC reference to zero reserve prices for on-the-day auctions. The arguments raised by respondents for and against UNC284 are similar to those for GCM19, and so we have not repeated them here.

UNC285

3.14. UNC285 proposes restricting the release of unused capacity at an entry point (UIOLI) as interruptible capacity to those occasions when 10 per cent or less firm baseline capacity remains unsold after the rolling monthly auctions.

Industry views in relation to the UNC relevant objectives

Efficient and economic operation of NTS

3.15. Some respondents considered that, in combination with GCM19, UNC285 would encourage more long-term bookings, if daily firm capacity was no longer available at discount and interruptible was only released when firm was close to selling out. It was argued that more long term bookings would allow for more efficiently planning of the NTS. Others thought this would not be the case as, if implemented on its own, there would still be firm capacity available at zero reserve price on-the-day.

3.16. However, the charging review group had concerns, echoed in the responses to the consultation, that UNC285 might have an adverse impact on the efficient and economic operation of the NTS. It was noted that there may be situations where the UIOLI amount of capacity is not released following the rolling monthly auctions, and firm capacity sells out at either the day-ahead or on-the-day auctions. In these circumstances, there is a risk no firm or interruptible capacity would be available on-the-day (even if capacity was being unused) and that shippers would not be able to procure capacity to flow gas. It was argued that if the capacity is physically there and not being used, then there should be no artificial restrictions from using it.

Efficient discharge of licence obligations

3.17. Some respondents to the consultation thought that there was undue preference for users of existing capacity since UIOLI was not made available at new entry points. They therefore argued that UNC285 would reduce the occasions on which UIOLI was released and so would reduce this differential treatment between users of new and existing capacity. However, others argued that this differential treatment is due to the different capacity allocation principles that apply at new entry points.

3.18. The effect of the proposal is that unused capacity would only be released as interruptible capacity when firm capacity is close to selling out. It was argued that this would increase the likelihood that non-firm capacity would be interrupted. These respondents argued that this would improve cost reflectivity of interruptible product vis-à-vis the firm product. It was also noted that EU regulations require the price of interruptible to reflect the probability of interruption.

Securing effective competition

3.19. Some respondents considered that limiting the release of large quantities of UIOLI at zero price to when 10 per cent or less of firm capacity remains unsold will encourage greater secondary trading of capacity. Others thought that as a result of less availability of interruptible capacity the GB market for gas would become less attractive which would reduce competition.

Proposal 3

3.20. We use the term "Proposal 3" to describe the idea of reallocating on-the-day sales of baseline entry capacity from SO revenues to be included as TO revenues, which includes removing these revenues from inclusion in the buy-back incentive and capacity neutrality mechanism²¹.

3.21. The arguments for Proposal 3 include that it would facilitate measures to reduce the TO commodity charge because increases in auction revenue would be directly matched by reductions in the revenue earned from commodity charges.

3.22. The arguments against Proposal 3 are that it had received little analysis, it would break significant linkages in current arrangements (notably on the buy-back incentive) and that the impacts of GCM19 on its own may be sufficient to reduce the TO commodity charge, such that system costs required for Proposal 3 are not required.

²¹ The operation of these mechanisms is described in Appendix 5

4. Key impacts of proposals in relation to relevant objectives

Chapter Summary

This chapter gives our initial assessment of each modification proposal, on its own merit, against the relevant objectives. This assessment leads to our provisionally preferred approach which is to veto/reject implementation of all proposals put forward, subject to full consideration of the consultation responses.

Questions

Question 1: Do you agree with our analysis of the proposals against the appropriate objectives?

Question 2: Do you agree with our provisionally preferred approach which would be to not implement any proposal to reallocate the revenues from baselines?

Question 3: Are there any other factors we should consider?

4.1. The review group discussions were aimed primarily at developing a set of proposals to increase the level of allowed revenue recovered by NGG from auctions and thus to reduce the TO entry commodity charge level and volatility.

4.2. However, the Authority is required to consider whether each modification proposal furthers the achievement of the relevant objectives and is consistent with relevant statutory duties and requirement including the requirement to ensure compliance with European law.

GCM19

4.3. GCM19 proposes removing reserve price discounts at firm daily entry capacity auctions so that the reserve price would equate to the level in the monthly auctions.

4.4. The charging methodology objectives are set out in standard special condition A5 of NGG's gas transportation licence (set out in full in Appendix 3). To summarise, these state that where charges are set by auction, either: no reserve price is applied; or, it is set at a level to promote efficiency, avoid undue preference and promote competition between gas suppliers and gas shippers. Other methodology objectives include the requirement for the charging methodology to be reflect costs incurred by the licensee in its transportation business, to account for developments in the transportation business and to facilitate effective competition between gas shippers and gas suppliers.

4.5. We consider that the removal of entry capacity discounts through GCM19/UNC284 is likely to result in the following main behavioural impacts:

- Less short-term firm entry capacity will be bought because purchasers will face higher prices
- There should be more secondary trading as a consequence of the release of lower amounts of UIOLI²²
- Shippers will be incentivised to buy capacity at least at the day-ahead stage because flat pricing between day-ahead and on-the-day will reduce the price incentive favouring either option, but all revenue from capacity bought day-ahead will be returned to the shipper community via lower TO commodity charges

Reserve prices

Promoting efficiency and avoiding undue preference

4.6. Respondents had argued that having a zero reserve price gives undue preference to those shippers booking short-term capacity, and that reserve prices were not being set at levels to promote efficiency.

4.7. The relevant objectives of cost reflectivity and non-discrimination are designed to simulate the network charges customers would face in a competitive gas transportation market. In that scenario, NGG NTS would supply capacity at a price equivalent to the marginal cost of producing it. Similarly, gas shippers would buy capacity up to the volume at which the marginal cost was equivalent to the marginal benefit in holding it.

4.8. Because NTS investment is lumpy (i.e. economies of scale mean that it is often inefficient to build capacity which exactly meets a user's incremental capacity requirements), and because NTS capacity does not perish after use (i.e. after being built the capacity is still there even where it is no longer required), capacity can sometimes be provided at no marginal cost (other than the cost of transporting gas).

4.9. Users booking existing entry capacity in the long and medium term entry capacity auctions currently face a reserve price on capacity equivalent to the long run marginal cost of providing incremental capacity. In our view this is appropriate. Reserving capacity in advance provides users with the certainty that the capacity will be available when they need it, and the premium such users place on this certainty is reflected in the reserve price.

4.10. Aside from providing information regarding long term capacity intentions, the auctions also ensure that, where existing entry capacity is scarce, those shippers who value the capacity most get it. If all capacity was offered without a reserve price in the annual or monthly auctions this could result in circumstances where a user could not obtain the capacity in day ahead or within day auctions.

²² This assumes that the capacity required to flow gas is the same but firm sales are reduced. Faced with the reserve price on unsold firm capacity shippers may investigate the possibility of trading with those that booked the capacity in the long-term, but who no longer require the capacity, at a price below the reserve price, to the benefit of both parties.

4.11. The majority of entry points have baselines which are not being fully used. Table 4.1 shows that 2009/10 peak demand on the system is only 56 per cent of the aggregate obligated entry capacity. The table also shows a downward trend in the ratio of peak demand to aggregate obligated capacity. Where demand is lower than the obligated capacity, short run marginal costs are relatively low (approximating zero). We consider that allowing the reserve price to drop to zero for on-the-day sales of capacity appropriately reflects the short-term marginal cost and therefore allows for a more efficient allocation of capacity.

Table 4.1: Peak demand on NTS against obligated entry capacity

Year	Obligated entry capacity (GWh/day)			Peak demand (GWh/day)	Peak observed	Peak as % of obligated
	Baseline	Incremental	Total			
2007/8	7,118.8	90 ²³	7,208.8	4600	17/12/07	64%
2008/9	7,449.4	325.4 ²⁴	7,774.8	4869	6/1/09	63%
2009/10	7,449.4	1,798.5 ²⁵	9,247.9	5136	8/1/10	56%

4.12. However, there are some entry points where baselines are either fully used, or very close to being fully used. In these cases the marginal cost of providing capacity will be more akin to the cost of providing additional capacity there.

4.13. Consequently, it does not appear to us that any undue preferential treatment is implied by the application of a zero reserve price - it would appear that the charging arrangements ensure that system users are exposed to the marginal costs of their actions. Likewise, we consider that the availability of short-term capacity at marginal cost should not be curtailed by the imposition of artificial price barriers, as this would hinder the efficient use of the system.

Promotion of Competition

4.14. Some respondents thought that GCM19 would improve price predictability and make the GB market more attractive for shippers, thereby promoting competition. Others thought GCM19 would reduce liquidity and be detrimental to competition.

4.15. Drawing on NGG's estimates, we analysed the impact that the increase in TO entry capacity revenue would have on the TO entry commodity charge. Our analysis suggests that GCM19 would result in a reduction in the TO commodity charge of between 0.0004 p/kWh and 0.0082 p/kWh (or between 2 and 42 per cent of the current charge). If a secondary market in trading capacity develops it might be expected that the impact will be towards the lower end of this range. Based on these numbers we are not convinced that the proposal will remove the volatility in

²³ Does not include incremental obligated at Garton (420GWh/day) and Milford Haven (650GWh/day) as had not been delivered by 17 December 2007.

²⁴ Does not include incremental obligated at Garton (420GWh/day) and Milford Haven (650 + 300 GWh/day) as had not been delivered by 6 January 2009.

²⁵ Does not include incremental obligated Milford Haven (300 GWh/day) as had not been delivered by 8 January 2010.

commodity charges. We are also not convinced there is evidence to suggest that predictability of TO entry commodity charges would be improved by implementing GCM19. As noted above, GCM19 may result in an increase in long-term entry capacity bookings. Increased long-term bookings of capacity have the potential to contribute to greater forward liquidity in the market for gas. However, in our June 2009 publication on 'Liquidity in the GB wholesale energy markets'²⁶ we noted that the forward liquidity in the GB wholesale gas market is higher than observed in a number of other gas and commodity markets and is likely to be sufficient for the hedging requirements of the majority of market participants. This suggests that the potential marginal improvements in forward liquidity are unlikely to be a material factor in evaluating GCM19.

4.16. Table 4.2 shows the average of day-ahead gas prices²⁷ and the range and variance of these prices. The average day-ahead price for gas is 1.0379 p/kWh. Our analysis above indicated that GCM19 would result in a reduction in TO commodity charges of between 0.0004 p/kWh and 0.0082 p/kWh. When considered in conjunction with the assumed higher capacity charges paid by some shippers post implementation of GCM19, the net change is between a decrease of 0.0081 p/kWh (for those booking long-term) to an increase of 0.0303 p/kWh (those buying on the day at the most expensive entry point).

Table 4.2: Day-ahead gas prices, 4 Jan 2000 to 24 May 2010, p/kWh

Minimum	0.1177
Maximum	6.6537
Mean	1.0379
Variance	0.3516

4.17. This average combined impact on capacity and commodity charges is in the range of a decrease in 0.0014 p/kWh to an increase in 0.0064 p/kWh, less than 1 per cent of the average day-ahead commodity price for gas. Therefore, we assess the impact on prices to be small. The range on day-ahead gas prices also indicates the potential value to be had from the certainty associated with long-term capacity bookings, and why some shippers preferentially book long-term entry capacity.

Cost reflectivity

4.18. Given our view that the marginal cost of providing capacity in the short term is low, then the zero reserve price may be considered to be more reflective of the costs imposed on the system than the proposals under GCM19. We would welcome views on whether GCM19 will improve cost reflectivity.

²⁶ See 'Liquidity in the GB wholesale energy markets', published on 8 June 2009 with Ref No 62/09 on the Ofgem website www.ofgem.gov.uk

²⁷ The analysis took the mid-point for contracts for gas signed day-ahead between 4 January 2000 and 24 May 2010. Source: ICIS Heren.

Developments in transportation business

4.19. The discounts in their current form were introduced when: NGG was over-recovering on its allowed revenue; Ofgem considered there was sufficient competition at the majority of beach terminals to avoid under-recovery; and we had concerns over NGG releasing sufficient amounts of capacity to the market.

4.20. We now face a situation where NGG fails to recover its allowed revenue through auctions; capacity at the majority of entry points is not fully used; there are low levels of competition for capacity in the short-term; NGG has baseline obligations to release capacity and incentives to release capacity beyond these baselines; and obligated levels of capacity are far greater than system peak usage.

4.21. Whereas GCM19 attempts to address the development of under-recovery of capacity charges, it does not frame this in the context of other equally important developments, such as the surplus capacity now evident in the system and attempts to address this through substitution mechanisms. Therefore, we do not consider that GCM19 holistically reflects developments in the transportation business.

Facilitating effective competition

4.22. The implications of GCM19 for competition has been described earlier in the section on setting reserve price to promote competition.

Summary

4.23. Ofgem's provisionally preferred approach is to veto implementation of GCM19.

4.24. Ofgem considers that the potential improvements in regard to setting the reserve price to promote efficiency and avoid undue preference from GCM19 are outweighed by the detriments.

UNC284

4.25. UNC284 proposes that the reserve price is as determined by the charging methodology statement; it would remove the wording from the UNC stating that the reserve price for the on-the-day auction is zero. Without implementation of GCM19 the reserve price for on-the-day auctions would remain at zero and, therefore, on its own, UNC284 has no impact.

4.26. The UNC objectives are set out in Appendix 6. In summary, these relate to efficient and economic operation of the NTS, co-ordinated, efficient and economic operation of various pipe systems, efficient discharge of NTS licence obligations, securing effective competition, providing incentives for suppliers to secure supply security standards and promotion of efficiency in implementation and administration of the uniform network code.

Efficient discharge of licence obligations

4.27. UNC284 is a consequential modification required to amend the UNC should GCM19 be implemented. Therefore if GCM19 is implemented, UNC284 would provide for efficient discharge of the licence objectives.

4.28. From our initial assessment of GCM19 above we consider that GCM19 would not further the relevant charging methodology objectives. Therefore, we consider that UNC284 does not further the UNC relevant objectives at SSC A11 of NGG's gas transporter licence. Our provisionally preferred approach, subject to responses, would therefore be to reject UNC284.

UNC285

4.29. UNC285 proposes restricting the release of unused capacity (UIOLI) as interruptible capacity to occasions when 10 per cent or less of capacity remains unsold after the rolling monthly auctions. We consider the main impacts to be:

- Shippers will be less able to buy UIOLI interruptible capacity at low cost at entry points not facing constraints. (At entry points where capacity sells out UIOLI will still be released at the same frequency). See our analysis in Appendix 7 for more details. The secondary market will, at best, only be marginally stimulated, since discounted firm capacity will still be available

Assessment against UNC relevant objectives*Efficient and economic operation of NTS*

4.30. Some respondents considered that UNC285 facilitated efficient planning of the NTS, while others thought it represented an inefficient use of assets by artificially restricting on-the-day capacity. Those respondents considered that UNC285 could not work without GCM19.

4.31. We consider the likelihood of a scenario where no capacity is available on-the-day as a result of UNC285 to be low. Our analysis in Appendix 7 suggests that there would have been no instances where this scenario arose in the last three winters. Furthermore, NGG has both incentives and licence requirements to release capacity

4.32. If UNC285 is considered on its own then NGG would still have to offer firm capacity on-the-day at zero reserve price and so there would be no benefits for a more efficiently planned NTS from more long-term signals.

4.33. We consider that it may be an inefficient use of existing capacity to deny access to interruptible users when they do not impose costs on the NTS to provide capacity and they would contribute to the marginal costs of operation via the commodity charge.

Efficient discharge of licence obligations

4.34. Ofgem agrees with the view made that if no physical capacity exists at an entry point, as is the case at new entry points, then interruptible capacity cannot be made available on a day-ahead basis. Therefore, differential treatment is based on the parties having relevant differences in characteristics and UNC 285 would not further the licence obligations regarding the charging obligation to set reserve prices to avoid undue preference.

4.35. We note that EU regulations²⁸ set out a requirement for the price of interruptible capacity to reflect the probability of interruption and that some comments from industry that UNC285 would better meet this requirement than the status quo. The Regulation allows for tariffs to be determined through auctions, provided that such arrangements and the revenues arising are approved by the regulatory authority. As the price for interruptible capacity is determined via auctions in GB we consider that the current arrangements comply with the Regulation.

Securing effective competition

4.36. Some respondents claimed that restricting UIOLI would stimulate secondary trading and promote competition, while others claimed it would reduce market attractiveness and so hinder competition.

4.37. Ofgem considers that restricting the release of unused capacity in the manner proposed in UNC285 would, at best, only marginally stimulate the secondary market since there would still be firm capacity made available at zero reserve price on-the-day. However, we are concerned that any stimulation to the secondary market would be artificial, which may not secure competition overall as UNC285 would limit the amount of capacity made available to the market. Furthermore through restricting the release of interruptible capacity, UNC285 could have a negative impact on short-term liquidity in the gas market by restricting access to capacity which is not being used. Reduced network usage due to restricting access to interruptible users could also be detrimental to competition.

Summary

4.38. Our provisionally preferred approach, subject to consideration of the responses to this consultation, is to reject implementation of UNC285. Artificially restricting access to unused capacity and discouraging interruptible users from access to the NTS would be an inefficient use of existing physical infrastructure, especially as their participation aids competition and if they flow gas they can contribute to the system running costs through the TO entry commodity charges. We consider that the limited potential benefits from the improvements to the secondary market from UNC285 would be outweighed by the detriment to efficient and economic operation of the NTS.

²⁸ See Regulation (EC) No 715/2009 of the European Parliament and the Council of 13 July 2009.

Proposal 3

4.39. We use the term "Proposal 3" to describe the idea of reallocating on-the-day sales of baseline entry capacity from SO revenues to be included as TO revenues, which includes removing these revenues from inclusion in the buy-back incentive and capacity neutrality mechanism. To date, no modification to the licence or UNC has been formally submitted in relation to this potential proposal.

4.40. However, we intend to set out our high level assessment of how this could impact on the UNC objectives, since a UNC modification would be required to modify the capacity neutrality scheme. We also consider impacts on Ofgem's principal objective and statutory duties, since a licence modification would be required to alter the allocation of revenues. This is in order to address the third main element of the proposals resulting from the review of the NTS entry charge setting arrangements. This assumes that it would be submitted to the Authority in its current state. This assessment does not fetter the discretion of the Authority in relation to any future proposals that it may have to consider in this regard.

Assessment against UNC objectives

Efficient discharge of licence obligations

4.41. Ofgem considers that although this change may seem relatively simple it does not account for the split between the SO and TO activities in the licence or the price control package as set for the SO and TO activities. Reallocating the revenues in the manner outlined may not be an appropriate matching of revenues against corresponding activities undertaken by the TO and SO, without a more detailed review.

Securing effective competition

4.42. Ofgem considers that the small decrease in TO entry commodity charge would be insufficient, on its own, to contribute to more predictable and stable charges regardless of the lack of evidence of a link between predictable charges and market participation (and security of supply).

Assessment against principal objective and statutory duties

Protecting consumers

4.43. Ofgem has considered the interests of existing and future consumers as a whole including their interests in the reduction of greenhouse gases and in the security of the supply of gas and electricity to them, and is of the view that Proposal 3 is unlikely to have any significant impacts since the amount of TO allowed revenue will not change and the amount of SO allowed revenue is not expected to change materially.

Promoting effective competition

4.44. As stated above we do not consider that the small increase in TO auction revenues that could result would be sufficient to have any impact on competition.

Summary

4.45. If such a proposal as Proposal 3 were submitted to the Authority our provisionally preferred approach, subject to this consultation, would be to reject its implementation.

4.46. The potential benefits from improved competition as a result of more predictable TO commodity charges would be negligible due to the small amount of revenue involved (£97,000) and lack of any evidence of link between charging predictability and market participation. We would also have to conduct a substantive analysis of the possible impacts of the reassignment of revenue from the SO to the TO, and how this could affect the underlying assumptions of the price control package.

5. Key impacts of options

Chapter summary

This chapter gives our qualitative and quantitative assessment of the interactions between the three main proposals. These include the effect of each on the Transmission Owner (TO) auction revenue and TO entry commodity charge, which was the main focus of the review of NTS entry charge setting arrangements, along with impacts on System Operator (SO) revenues.

Questions

Question 1: Do you agree with our analysis of each of the options against the measures we consider?

Question 2: Are there any other measures we should have assessed the options against?

5.1. In the previous chapter we set out our assessment of each of the proposals as stand-alone proposals against the relevant objectives along with some qualitative and quantitative analysis of the impacts. However, as these proposals were considered as a suite of measures designed through the review of the NTS entry charge setting arrangements their combined interactions should also be assessed.

5.2. Table 5.1 below shows the various combinations possible, where 'X' signifies acceptance/non-veto and a blank signifies rejection/veto. In this chapter we assess these different options (except Option 1, the status quo) in terms of their impacts on TO and SO revenues. A table summarising our conclusions is given as Appendix 8.

Table 5.1: Range of combinations on proposal decisions

Option Number	1	2	3	4	5	6	7	8
GCM19/UNC284		X			X	X		X
Proposal 3			X		X		X	X
UNC285				X		X	X	X

Impact on revenues

Impacts of Option 2

5.3. Less short term capacity will be bought, due to the greater prices faced by purchasers. Any short-term capacity purchases are likely to be bought at least day-ahead, as all of this revenue is recycled to shippers through reduced commodity charges. The reduction in on-the-day capacity sales will cause a small reduction in

NGG's SO allowed revenue. Secondary trading should be stimulated as a result of the reduction in UIOLI being released. TO capacity revenue could increase by between £3m and £71m.

Impacts of Option 3

5.4. The revenue impact would seem to be of the order of £93K, as revenue from on-the-day capacity sales transfers from the SO to the TO. The effect on commodity charge is negligible.

Impacts of Option 4

5.5. Option 4 on its own would not be expected to bring about any change in revenue, since discounted firm products will still be available.

Impacts of Option 5

5.6. Option 5 would appear to have an impact of similar magnitude to option 2, but with the addition that the on-the-day capacity revenues are offset against the TO commodity charge.

Impacts of Option 6

5.7. Option 6 represents approval of the modifications UNC284 and UNC285, and the non-veto of GCM19. As indicated by NGG's analysis, the revenue impact is between £3m - £71m, with the impact starting off in the high end of this range, but declining as secondary trading develops.

Impacts of Option 7

5.8. We would not expect option 7 to bring about significant change in TO revenues, as firm capacity is still available to purchase at discounted rates in the short-term.

Impacts of Option 8

5.9. We expect Option 8 to have the greatest impact of the combinations, though the impact is only marginally greater than option 6, due to the transfer of revenues from SO to TO.

6. Assessment of other impacts

Chapter summary

This section provides an assessment of the proposals and options against the principal objective of the Authority and other considerations which have not been addressed already in this impact assessment.

Questions

Question 1: Do you agree with our analysis on the impacts of the options on existing and future consumers being their interests as a whole in terms of both security of supply and reduction of greenhouse gases?

Question 2: Do you agree with our analysis on the impacts on health and safety?

Question 3: Do you agree with the risks and unintended consequences we have identified?

Question 4: Are there any other impacts we should have addressed?

Impacts on consumers

6.1. Ofgem's principal objective is to protect the interests of existing and future consumers in relation to gas conveyed through pipes and electricity conveyed by distribution or transmission systems. The interests of such consumers are their interests taken as a whole, including their interests in the reduction of greenhouse gases and security of supply to them. Further detail of how the Authority is generally required to carry out its functions in the manner it considers is best calculated to further the principal objective is set out in Appendix 9.

6.2. We expect the impacts of Options 2, 5, 6 and 8 on security of supply to be marginal. In these options the reserve price discounts have been removed, which is expected to result in marginally more long-term signals for capacity, which aid in planning and developing a network appropriate to the needs to ensure that demands for capacity in GB are met. As the potential range of impacts of these options on the TO commodity charge are rather wide, we expect only marginal improvements in predictability of entry charges.

6.3. Some commentators consider that the options will lead to greater predictability in entry charges which could encourage market participants, which should be beneficial to securing supplies. However, we have not been presented with compelling evidence on this point. We would welcome views and evidence on the link between charging predictability and investment activity. If the link is not strong, the impact of the proposal on security of supply is likely to be limited.

6.4. Options 4, 6, 7 and 8, which restrict the release of interruptible may reduce access to the NTS of interruptible users, this again may be marginally detrimental to securing gas supplies. We consider this negative impact on security of supply to be at least as significant as any positive marginal impacts noted above for Options 6 and 8.

Impacts on greenhouse gases

6.5. We do not expect the proposals to result in any significant reduction in greenhouse gas emissions. Aggregate amounts of gas flowing through the NTS are not expected to change as a result of the options.

Impacts on health and safety

6.6. We do not expect there to be any direct impacts on health and safety from the range of proposals and options that have been assessed.

Risks and unintended consequences

6.7. Ofgem notes that the review of NTS entry charging arrangements suggests that the combination of GCM19 and UNC285 would result in maximising the amount of TO entry allowed revenue recovered from auctions. The range of expected increases in revenue from auctions, resulting from these proposals, is estimated by NGG to be between £3 million and £71 million, depending on the extent of secondary trading, with more secondary trading leading to increases in auction revenues at the lower end of this range. Analysis suggests that the secondary market may be stimulated more when UNC285 is implemented in combination with GCM19 than GCM19 on its own. Therefore, it may be that auction revenue increases are not maximised by a combination of GCM19 and UNC285 (i.e. Options 6 and 8) as was initially expected. Acceptance of the proposals could lead to the inadvertent withholding of available capacity at times of high system demand, although we think this is unlikely.

7. Conclusions and way forward

Chapter summary

This section sets out our conclusions and our provisionally preferred approach which is not to implement any of GCM19, UNC284 or UNC285. This is subject to full consideration of the consultation responses.

Questions

Question 1: Do you agree with our conclusions?

Question 2: Are there any other issues that need to be raised to inform the Authority's decisions on these proposals?

Conclusions

GCM19

7.1. Our provisionally preferred approach is to veto GCM19, subject to the consultation responses.

7.2. Our view is that marginal cost pricing allows for efficient allocation of NTS entry capacity and that the short-run marginal cost of providing access to entry capacity at the day-ahead or on-the-day is relatively small compared to long-run marginal cost of providing additional entry capacity. GCM19 would introduce flat reserve prices for long and short term auctions of NTS entry capacity which would move away from cost-reflective pricing. We consider that this would be detrimental to one of the principal charging methodology objectives of setting reserve prices to promote efficiency. This would also increase the potential for cross-subsidies which would be contrary to other principal charging methodology objectives of setting the reserve price to avoid undue preference and promote competition.

7.3. We consider there is considerable uncertainty in estimates of the impact of GCM19 on TO entry commodity charges and, therefore the benefits from greater predictability may not be so evident. There is a lack of evidence that any such improvement in predictability leads to increased market participation and improvements to competition and security of supply. We also consider that GCM19 will not result in significantly more capacity being bought in the long-term as users will use short-term auctions to fine-tune their capacity requirements. Therefore the benefits efficiency from greater long-term bookings in terms of developing an appropriately sized NTS are marginal.

UNC284

7.4. Our provisionally preferred approach, subject to the consideration of consultation responses, is to veto UNC284. As UNC 284 has no impact without

GCM19 being implemented, and our provisionally preferred approach is to veto GCM19, then we would also reject implementation of UNC284.

UNC285

7.5. Our provisionally preferred approach is to reject UNC285, subject to the consultation responses. We consider that artificially restricting access to unused capacity discourages low-value users of interruptible capacity when they impose few costs in terms of providing capacity day-ahead but are prepared to contribute to the marginal cost of accessing the NTS through the commodity charges. Discouraging such users would be an inefficient use of the existing NTS as their participation promotes competition and security of supply.

Proposal 3

7.6. No modifications have been submitted to the Authority for decision on whether to designate revenues from on-the-day sales of baselines as TO revenue. However, without fettering the discretion of the Authority in relation to any future proposals in this regard, we consider it beneficial to provide industry with our view on any such modifications as these have been discussed as part of the review of NTS entry charge setting arrangements.

7.7. Given our provisionally preferred approach is to veto/reject GCM19, UNC284 and UNC285, Proposal 3 would be expected to provide only small amounts of additional revenues from TO entry capacity auctions, which was one of the aims of the review of NTS entry charge setting arrangements. However, there are potential and, as yet, un-assessed implications of altering the split between TO and SO revenues. Therefore, our provisionally preferred approach would be not to implement any proposals to reallocate revenue from on-the-day sales of baseline entry capacity, subject to the consultation responses.

Intended process

7.8. We are seeking responses to this document by 22 July 2010. Following full consideration of the responses we aim to make our decision on these before 31 July 2010.

Appendices

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Appendix 1 - Consultation Response and Questions

1.1. Ofgem would like to hear the views of interested parties in relation to any of the issues set out in this document.

1.2. We would especially welcome responses to the specific questions which we have set out at the beginning of each chapter heading and which are replicated below.

1.3. Responses should be received by 22 July 2010 and should be sent to:

- Richard Miller
- Gas Transmission Policy
- Ofgem, 107 West Regent Street, Glasgow, G2 2BA
- 0141 331 6013
- Gas.TransmissionResponse@ofgem.gov.uk

1.4. Unless marked confidential, all responses will be published by placing them in Ofgem's library and on its website www.ofgem.gov.uk. Respondents may request that their response is kept confidential. Ofgem shall respect this request, subject to any obligations to disclose information, for example, under the Freedom of Information Act 2000 or the Environmental Information Regulations 2004.

1.5. Respondents who wish to have their responses remain confidential should clearly mark the document/s to that effect and include the reasons for confidentiality. It would be helpful if responses could be submitted both electronically and in writing. Respondents are asked to put any confidential material in the appendices to their responses.

1.6. Next steps: Having considered the responses to this consultation, Ofgem intends to review them in light of the modification proposals, with a view to informing the Authority's decision. Any questions on this document should, in the first instance, be directed to:

- Paul O'Donovan
- Gas Transmission Policy
- Ofgem, 9 Millbank, London SW1P 3GE
- 020 7901 7414
- Gas.TransmissionResponse@ofgem.gov.uk

CHAPTER: Three

Question 1: Do you agree with NGG's analysis on the impacts of removing the reserve price discounts?

CHAPTER: Four

Question 1: Do you agree with our analysis of the proposals against the appropriate objectives?

Question 2: Do you agree with our provisionally preferred approach which would be to not implement any proposal to reallocate the revenues from baselines?

Question 3: Are there any other factors we should consider?

CHAPTER: Five

Question 1: Do you agree with our analysis of each of the options against the measures we consider?

Question 2: Are there any other measures we should have assessed the options against?

CHAPTER: Six

Question 1: Do you agree with our analysis on the impacts of the options on existing and future consumers being their interests as a whole in terms of both security of supply and reduction of greenhouse gases?

Question 2: Do you agree with our analysis on the impacts on health and safety?

Question 3: Do you agree with the risks and unintended consequences we have identified?

Question 4: Are there any other impacts we should have addressed?

CHAPTER: Seven

Question 1: Do you agree with our conclusions?

Question 2: Are there any other issues that need to be raised to inform the Authority's decisions on these proposals?

Appendix 2 – Development of gas transmission entry regime

Mod	Date	Impact
PC36 ²⁹	Nov 1998	DSEC floor price set at 4 times the daily rate of annual capacity charges. DISEC floor price set at zero.
PC48 ³⁰	Jul 1999	MSEC floor prices based on 25% discount on established LPMC methodology.
PC49	Aug 1999	Unsold MSEC sold at cleared price in relevant monthly auction. DSEC floor price set at 1.5 times daily rate of cleared price in relevant monthly auction, or daily rate of published charge where auctions of monthly capacity not offered. DISEC floor price set at 0.1 times daily rate of cleared price in relevant monthly auction, or 0.1 times daily rate of published charge.
PC51 ³¹	Jan 2000	Set DSEC floor price at the daily rate of cleared price in relevant monthly auction.
PC61	May 2000	MSEC floor price calculations account for the quantities for sale in the Network Code. Adjustment for 50:50 entry/exit split removed.
PC62	May 2000	DSEC floor prices follow same methodology as MSEC but 50% discount applied to adjusted administered charge. Interruptible floor prices follow same methodology as that for MSEC but 90% discount applied to adjusted administered charge. Otherwise, DISEC floor prices set at zero.
SO price control 2002-7	Dec 2001	Split regulation of NTS into two main roles: (i) TO - to build and maintain the NTS (ii) SO - to determine need for incremental capacity and operating the system day to day.
0500	Sep 2002	Introduced QSEC auctions. MSEC offered i) at annual auctions ii) on rolling month ahead basis DSEC offered on day-ahead and on-the-day basis DISEC offered day-ahead from UIOLI amount Baseline obligated amounts of capacity to be offered.
PC76 ³²	Nov 2002	MSEC reserve prices set equal to QSEC reserve prices. Relationship between MSEC and DADSEC preserved with DADSEC reserve price set at 2/3 of MSEC reserve price WDDSEC reserve price set at zero DISEC reserve price remained at zero
PC78	Jul 2004	Introduced TO entry commodity charge - except on storage flows.
GCM01	Apr 2007	Introduced the Transportation Model.

1.1. The table sets out the key changes to the gas transmission entry regime which have led to the current regime of auctions with various reserve prices applying.

²⁹ DSEC and DISEC products were sold through tender process where shippers paid market clearing price. Prior to introduction of auctions annual charges were based on administered prices that were based on LRMCs adjusted to recovered allowed revenue

³⁰ The first MSEC auctions had no baseline obligations and resulted in large over-recovery. The discount applied was to limit over-recovery.

³¹ Modification 0365 introduced a within day capacity mechanism from 1 April 2000.

³² Clearing allocation obligation introduced

Appendix 3 - Consultation responses

GCM19

1.1. There were eight responses to GCM19 (one of which was submitted on a confidential basis), five of which support implementation whilst three did not support it being implemented.

Should the discounts that apply to day-ahead (DADSEC) firm daily entry capacity be removed?

1.2. Five respondents supported removal of the discounts that apply to day-ahead firm daily entry capacity.

1.3. One respondent cited reasons that the discounts perpetuate shipper behaviour of delaying capacity purchases without any risk that that capacity will not be available such that they can be bought at low cost. Another respondent noted that removing discounts would improve price predictability and remove cross subsidies (from shippers booking long term capacity to those booking short term capacity). Some respondents noted that such cross subsidies are detrimental to competition and suppress incentives to secure long term capacity

1.4. Three respondents did not support the removal of the discounts applying to day-ahead firm daily entry capacity.

1.5. One respondent note that shippers require a stable regulatory regime and that these proposals may be superseded by development in Europe. It continued that GCM19 would contradict Ofgem recommendations in Project Discovery to invest significantly to meet security of supply and would reduce gas market liquidity if traders discouraged from short term trades if short term physical capacity restricted via price. It was concerned that no analysis had been done of impact of different sizes of shippers as could be detrimental to smaller suppliers. This respondent also had concerns that would be detrimental to producers of marginal offshore fields that rely on short-term capacity products, as increased capacity costs could make these fields less viable and reduce their life expectancy.

1.6. Another respondent not in support considered that the market should decide the price for short-term capacity with no reserve price in place as this artificially constrains supply and demand balancing. It also thought that those shippers buying capacity in the short-term face the risk that capacity will have been sold out in earlier auctions.

Should the discounts that apply to within-day (WDDSEC) firm daily entry capacity be removed?

1.7. Five respondents supported removal of the discounts that apply to within day firm daily entry capacity. Whereas, three respondents did not support the removal of the discounts applying to within day firm daily entry capacity. The arguments used in relation to the discounts for day-ahead capacity were similar to those for within-day capacity.

1.8. However, one respondent noted revenues from within-day sales of firm capacity are classed as SO revenues and recycled back to shippers via the capacity neutrality mechanism. It thought that changes to the reserve price for within-day capacity would therefore have no impact on TO commodity charges unless the licence and UNC are modified accordingly. It considered that without the necessary licence and UNC modifications shippers would be motivated further to buy capacity on-the-day as opposed to the similar priced day-ahead capacity since revenues from on-the-day capacity would be recycled back to shippers via capacity neutrality.

Should revenue from the sale of within-day Obligated Daily NTS Entry Capacity (if not redistributed via capacity neutrality) be treated as TO revenue for charge setting purposes?

1.9. Of those responding to this question five were in support of the revenue sale of within-day obligated daily entry capacity being treated as TO revenue and not redistributed via the capacity neutrality mechanism, whilst two were not in support.

1.10. Those not in support note that here appears to be significant linkages that would be broken as a result and very little analysis has been done to date on this. Another noted that no analysis had been done on whether this would reduce NGG's incentive to maximise release of entry capacity.

Other comments

1.11. One respondent thought that GCM19 would reduce TO entry commodity charges which would make the GB market more attractive than elsewhere in EU which should benefit competition and security of supply. It also noted that removal of discounts on reserve price of short-term capacity will create a level playing field between those booking long- and short-term. It also agrees with NGG that European Regulators' Group for Electricity and Gas (ERGEG) guidelines are focussed on interconnectors.

1.12. Another respondent noted that GCM19 should increase liquidity in the secondary market for capacity as will no longer be undermined by low price for firm capacity.

1.13. One respondent against GCM19 notes that it will achieve very little in terms of reducing TO entry commodity charge, unless reserve price multipliers are employed, but imposes large costs. It also noted that TO entry commodity charge variability is

inevitable from the result of auctions being used to recover fixed revenues. Another thought that the impact of generally higher reserve prices as a result of the introduction of the transportation model in 2007 has yet to be fully observed and may lead to the increased auction revenues in the future.

UNC284

1.14. Twelve responses were received to the UNC284 modification report eight of which were in favour of implementing the proposals with the remainder against.

1.15. The modification proposer suggested the proposals further facilitated the achievement of the following UNC objectives:

- Standard Special Condition (SSC) A11.1 (a): the efficient and economic operation of the pipe-line system to which this licence relates;
- SSC A11.1 (c): so far as is consistent with subparagraphs (a) and (b), the efficient discharge of the licensee's obligations under this licence; and
- SSC A11.1 (d): so far as is consistent with subparagraphs (a) to (c) the securing of effective competition.

Efficient and economic operation of the pipe-line system

1.16. Respondents in favour of the modification noted the proposals would further the achievement of SSC A11.1 (a) by encouraging the longer term booking of entry capacity through removing the price incentive to book capacity within the day of need.

1.17. Respondents against the proposal stated the UNC modification only removes the WDDSEC discount and if other discounts are not removed Shippers would alter their purchasing strategies towards buying DADSEC capacity. They were also concerned that the removal of the within day discount could lead to the early closure of declining North Sea gas fields as operators of these fields may be unable to form a long term view of what their capacity requirements are. Another respondent was concerned that the removal of the discount could encourage the inefficient booking of long term capacity which could send erroneous investment signals to NGG.

Efficient discharge of licence objectives

1.18. Respondents in favour of the modification stated the proposals will facilitate the achievement of SSC A11.1 (c) by improving cost reflectivity through creating a better distribution of charges between Shippers. At present, the TO commodity charge collects a large amount of TO allowed revenue which this respondent thought may result in a redistribution of charges from users acquiring discounted capacity to those who have paid a "full" rate for long term capacity. They also considered the modification will remove potential discrimination against users at new entry points that have limited opportunity to purchase zero priced capacity when compared to existing entry points.

1.19. Those respondents against the proposal questioned how removing the discount is consistent with the licence condition to have a zero priced within day auction. They also noted the introduction of substitution, transfer and trade, and the threat of baseline resetting has increased risk that short term capacity may not be available. Therefore, they argued it is not consistent to apply same reserve price to both long term and WDDSEC capacity.

Securing effective competition

1.20. Some respondents considered the modification would further the achievement of SSC A11.1 (d) as it would encourage longer term booking of capacity and lead to the further utilisation of secondary trading market. Other Shippers were concerned that the modification does not recognise the operational requirements of Shippers and no analysis on competition impacts has been conducted. In particular, NGG will recover the same level of TO allowed revenue but there will be "winners" and "losers" in Shipper community who have not been identified by NGG.

UNC285

1.21. Thirteen responses were received to UNC285 eight of which supported implementation of the modification with the remainder against.

1.22. The modification proposer suggested the modification further achieved the following relevant objectives:

- Standard Special Condition (SSC) A11.1 (a): the efficient and economic operation of the pipe-line system to which this licence relates;
- SSC A11.1 (c): so far as is consistent with subparagraphs (a) and (b), the efficient discharge of the licensee's obligations under this licence; and
- SSC A11.1 (d): so far as is consistent with subparagraphs (a) to (c) the securing of effective competition.

Efficient and economic operation of the pipe-line system

1.23. The respondents in favour of the modification noted that the proposal will encourage longer term capacity booking by removing the price incentive to book capacity close to day of intended use. They also noted that it is inequitable to place more of a burden for revenue recovery on the commodity charge rather than capacity charges which can place GB at a material disadvantage for attracting incremental supplies.

1.24. Respondents against the proposal noted it is unlikely the modification alone will encourage long term booking of capacity as Shippers who currently purchase interruptible capacity will switch to purchasing within day firm capacity instead (since this would still be available at zero reserve price).

1.25. Respondents were also concerned that no analysis had been done on whether the proposal will restrict interruptible capacity which historically has been released and flowed against to meet peak demand. This could force NGG to take more balancing actions in the market. There was also concern that the proposal will reduce the attractiveness of maintaining declining oil fields which makes them likely to be decommissioned earlier than expected.

Efficient discharge of licence objectives

1.26. Respondents in favour of the proposal noted it will improve cost reflectivity through a more apt and fair distribution of charges. They stated using the TO commodity charge to collect large amount of revenue may result in cross subsidisation and undue preference for certain Shippers.

1.27. A respondent against the proposal noted it would not achieve this relevant objective as the modification will not ensure equal treatment of new and existing entry points.

Securing effective competition

1.28. Respondents noted the proposal will increase competition as it will reduce the large amounts of capacity bought at zero price and incentivise purchase of long term capacity. This will facilitate the secondary market. It was also stated that there is an inherent bias against users at new entry points due to them not having access to large amounts of UIOLI interruptible capacity at zero reserve price (which are available at existing entry points), which the proposal will remove and so create a more balanced system.

1.29. Respondents against the proposal stated it will not encourage Shippers to utilise the secondary trading market. The proposal does not reflect the operational requirements of Shippers who have portfolio of supplies or recognise there will be "winners" and "losers" as NGG will still recover the same amount of allowed revenue. They also argue that the reason for users at new entry points not having access to UIOLI is that no physical connection is at the new entry points and therefore interruptible capacity cannot physically be made available at the day-ahead stage.

Appendix 4 - Capacity constraint in 2007/8

- 1.1. At the 2007 QSEC auction a signal for 345 GWh/day of incremental entry capacity to be delivered at Easington in October 2009 was received.
- 1.2. At the subsequent AMSEC auction in February 2007 there was limited baseline capacity made available for the two winter periods 2007/8 and 2008/9 - up to 20 per cent of baseline was made available in each of the winter months.
- 1.3. The combination of the desire for incremental capacity and limited capacity remaining unsold and being offered at the 2007 AMSEC auction resulted in a significant level of competition for the remaining capacity in the two winter periods.
- 1.4. This competition resulted in high bid prices received for capacity at Easington in the winter months - the maximum bid price observed was 0.5108 p/kWh/day which was in excess of the reserve price of 0.0011 p/kWh/day.
- 1.5. The impact of the high bid prices in the 2007 AMSEC auction was that revenues from capacity at Easington were around £67 million for the 2007/8 year (the total auction revenue was £82 million for 2007/8). This was a considerable amount recovered against the TO entry allowed revenue of £ 250 million.
- 1.6. These high auction revenues had not been anticipated by NGG before the auction when it set its TO entry commodity price at 0.0120 p/kWh, which was effective from April 2007. In order to avoid significant over-recovery for 2007/8 NGG reset the TO entry commodity charge at zero from October 2007.
- 1.7. TO entry commodity prices were reset again in early 2008, before the 2008 QSEC auction, to be effective from April 2008. This requires a forecast of the auction revenues, and given what had happened in the 2007 AMSEC auction it was considered that high bid prices would be observed again. The TO entry commodity charge was therefore set at a low level of 0.0019 p/kWh. However, the 2008 AMSEC auction did not produce the levels of revenue observed a year earlier. The auction revenue for Easington for the 2008/9 year was £29 million (and total auction revenue for 2008/9 was £37 million).
- 1.8. Therefore when the TO entry commodity charge was reset from October 2008 it rose substantially to 0.0102 p/kWh to avoid significant under-recovery.

Appendix 5 - Capacity Neutrality and buy-back incentives

1.1. The following paragraphs provide a brief overview of the capacity neutrality and buy-back arrangements.

Capacity neutrality arrangements

1.2. The aim of the capacity neutrality arrangements work is that NGG should not gain or lose from actions to maximise capacity availability, including as a result of any consequential congestion management actions.

1.3. The UNC defines 'relevant capacity costs' as costs NGG incurs mainly relating to managing constraints. These include buy-back costs amongst other things. These costs are recycled back to NGG via the capacity neutrality mechanism such that each user pays NGG the relevant capacity costs multiplied by that user's share of firm entry capacity allocations. NGG receives revenues from various charges which comprise the 'relevant capacity revenues' as defined in the UNC. These include capacity charges for:

- On-the-day sales of entry capacity (including baselines, incremental and discretionary)
- Daily interruptible entry capacity
- discretionary firm

Entry capacity operational buy-back incentive

1.4. One of the incentives which contributes to the calculation of NGG's SO maximum allowed revenue is the entry capacity operational buy-back incentive. This incentive allows NGG to increase its SO allowed revenue if it can contain the costs of entry capacity buy-back (other than incremental capacity signalled after 31 March 2007). The incentive also allows NGG to increase the revenue from the sale of a number of entry capacity products (including on-the-day entry capacity, interruptible capacity and discretionary firm capacity).

1.5. All other things being equal and subject to a cap and collar arrangement, NGG keeps 50 per cent of the amount of revenue it collects from the sale of on-the-day baseline and incremental capacity, interruptible capacity and discretionary firm capacity through this incentive. The cap is set at £13.5 million. Losses from the incentive are subject to a £10 million collar.

1.6. If the revenue from on-the-day sales of baseline is classed as TO revenue instead of SO revenue (and including that any contribution to the buy-back incentive revenue is also removed) and is no longer recycled via the capacity neutrality scheme, there would be a number of main impacts:

- revenue from on-the-day sales of baseline capacity would increase; as an illustration of the magnitude of this effect, TO entry capacity revenue collected via auctions in 2008/9 was £93,000;
- the increase in auction revenue would lead to a concomitant decrease the shortfall to be recovered from the TO entry commodity charge and
- an equivalent reduction in SO revenue collected of £93,000.
- the SO allowed revenue would decrease by £46,500 as half the revenue from on-the-day sales contributes to the buy-back incentive, and ultimately the SO allowed revenue.
- the difference in SO allowed and collected revenue would result in marginally SO higher charges to shippers of £46,500.
- the revenue from on-the-day sales of baselines of £93,000 would no longer be recycled back to shippers so they would face a small negative impact.

Appendix 6 - Charging methodology and UNC objectives

Charging methodology objectives

1.1. Standard special condition A5 of NGG's gas transporter licence sets out the relevant licence objectives with which the gas transmission transportation charging methodology must conform. These are:

- a. save in so far as paragraphs (aa) or (d) apply, that compliance with the charging methodology results in charges which reflect the costs incurred by the licensee in its transportation business;
 - aa. that, in so far as prices in respect of transportation arrangements are established by auction, either:
 - i. no reserve price is applied, or
 - ii. that reserve price is set at a level -
 - (I) best calculated to promote efficiency and avoid undue preference in the supply of transportation services; and
 - (II) best calculated to promote competition between gas suppliers and between gas shippers;
- b. that, so far as is consistent with sub-paragraph (a), the charging methodology properly takes account of developments in the transportation business;
- c. that, so far as is consistent with sub-paragraphs (a) and (b), compliance with the charging methodology facilitates effective competition between gas shippers and between gas suppliers; and
- d. that the charging methodology reflects any alternative arrangements put in place in accordance with a determination made by the Secretary of State under paragraph 2A(a) of Standard Special Condition A27 (Disposal of Assets).

UNC objectives

1.2. Standard special condition A11 of NGG's gas transporter licence sets out the relevant licence objectives in relation to the UNC. These are:

- a. The efficient and economic operation of the pipeline system to which the NGG NTS licence relates;
- b. So far as is consistent with sub-paragraph (a), the coordinated, efficient and economic operation of (i) the combined pipe-line system, and/or (ii) the pipe-line system of one of more other relevant gas transporters;
- c. So far as is consistent with sub-paragraphs (a) and (b), the efficient discharge of the licensee's obligations under the licence;
- d. So far as is consistent with sub-paragraphs (a) to (c), the securing of effective competition:
 - i. Between relevant shippers;
 - ii. Between relevant suppliers; and/or
 - iii. Between GDN operators (who have entered into transportation arrangements with other relevant gas transporters) and relevant shippers.

- e. So far as is consistent with sub-paragraphs (a) to (d), the provision of reasonable economic incentives for relevant suppliers to secure that the domestic customer supply security standards are satisfied as respects the availability of gas to their domestic customers; and
- f. So far as is consistent with sub-paragraphs (a) to (e), the promotion of efficiency in the implementation and administration of the network code and/or the uniform network code.

Appendix 7 - Analysis of UNC285

1.1. A concern raised over implementation of UNC285 was the scenario whereby

- firm sales of obligated capacity after the RMTTSEC auction would be insufficient (i.e. less than 90 per cent of obligated capacity) to release UIOLI, and
- firm obligated capacity sold out at the DADSEC auction

1.2. The concern was that this would result in no UIOLI being offered for sale at the DADSEC auction and no firm obligated capacity available at the WDDSEC auction.

1.3. As can be seen from the tables below there would have been no instances where this scenario would have arisen in the last three winters for the identified entry points.

1.4. There was also a concern that the assessment of unsold obligated firm capacity should include the results of the DADSEC auctions. However, the outcome would have only differed on 31 days at Theddlethorpe in 2008/9 and three days at St Fergus in 2007/8.

Table A7.1: Winter 2009/10 (185 days)

Entry Point	Number of days when:			% Flows against obligations	
	Unsold >10% after RMTTSEC but sold out after DADSEC	UIOLI amount released if assessment of unsold done after		Maximum	Mean
		RMTTSEC	DADSEC		
Bacton	0	0	0	75%	46%
Barrow	0	0	0	78%	41%
Easington	0	181	181	96%	64%
Garton	0	182	182	30%	5%
Hatfield Moor	0	90	90	81%	22%
Hornsea	0	0	0	81%	13%
Isle of Grain	0	182	182	69%	28%
Milford Haven	0	182	182	65%	40%
St Fergus	0	0	0	66%	53%
Teesside	0	0	0	68%	56%
Theddlethorpe	0	0	0	32%	28%

Table A7.2: Winter 2008/9 (182 days)

Entry Point	Number of days when:		% Flows against obligations		
	Unsold >10% after RMTTSEC but sold out after DADSEC	UIOLI amount released if assessment of unsold done after		Maximum ³³	Mean
		RMTTSEC	DADSEC		
Bacton	0	0	0	69%	47%
Barrow	0	92	92	60%	40%
Easington	0	182	182	120%	84%
Garton	n/a	n/a	n/a	n/a	n/a
Hatfield Moor	0	151	151	80%	19%
Hornsea	0	120	120	110%	12%
Isle of Grain	0	180	180	69%	17%
Milford Haven	n/a	n/a	n/a	n/a	n/a
St Fergus	0	0	0	80%	71%
Teesside	0	0	0	73%	58%
Theddlethorpe	0	0	31	40%	34%

Table A7.3: Winter 2007/8 (144 days)

Entry Point	Number of days when:		% Flows against obligations		
	Unsold >10% after RMTTSEC but sold out after DADSEC	UIOLI amount released if assessment of unsold done after		Maximum ³⁴	Mean
		RMTTSEC	DADSEC		
Bacton	0	0	1	71%	56%
Barrow	0	144	144	69%	63%
Easington	0	135	135	105%	71%
Garton	n/a	n/a	n/a	n/a	n/a
Hatfield Moor	0	90	90	135%	38%
Hornsea	0	115	115	99%	13%
Isle of Grain	0	121	121	9631% ³⁵	1282%
Milford Haven	n/a	n/a	n/a	n/a	n/a
St Fergus	0	61	64	85%	71%
Teesside	0	128	128	78%	59%
Theddlethorpe	0	38	38	149%	60%

³³ A combination of discretionary firm and discretionary interruptible and UIOLI interruptible were used to flow above obligations at certain entry points.

³⁴ A combination of discretionary firm and discretionary interruptible and UIOLI interruptible were used to flow above obligations at certain entry points.

³⁵ In December 2007 and January 2008 most of the baseline was transferred away but large amounts of discretionary firm and interruptible made as well as UIOLI which were used to flow above the reduced obligations.

Appendix 8 - Summary of interactions

Table A8.1: Qualitative and Quantitative impact of different options

Option	1	2	3	4	5	6	7	8
GCM19 Proposal 3 UNC285		X	X	X	X X	X	X X	X X X
Outcomes								
Firm sales		Lower	No change	No change	Lower	Lower	No change	Lower
UIOLI quantity		Lower	No change	Lower	Lower	Lower	Lower	Lower
UIOLI release frequency		No change	No change	Lower	No change	Lower	Lower	Lower
TO auction revenue increase & Ranking of effect		4) £3m to £71m less interruptible and small amount from on-the-day sales	=5) £93k	7) £0	2) £3m to £71m less interruptible sales	3) £3m to £71m less interruptible and small amount from on-the-day sales	=5) £93k	1) £3m to £71m less interruptible sales
TO commodity charge, p/kWh		Lower by 0.0004 to 0.0082	Negligible change	No change	Lower by 0.0004 to 0.0082	Lower by 0.0004 to 0.0082	Lower by 0.0004 to 0.0082	Lower by 0.0004 to 0.0082
SO revenue collected		Lower by up to £93k	Lower by £93k	Little or no change	Lower by £93k	Lower by up to £93k	Lower by £93k	Lower by £93k
SO allowed revenue		Lower by up to £46k	Lower by £46k	Little or no change	Lower by £46k	Lower by up to £46k	Lower by £46k	Lower by £46k
Available capacity on-the-day		Firm likely to be available but not at discount	No change	No change	Firm likely to be available but not at discount	Firm likely to be available but not at discount	Firm likely to be available but not at discount	Firm likely to be available but not at discount

Appendix 9 – The Authority’s Powers and Duties

1.1. Ofgem is the Office of Gas and Electricity Markets which supports the Gas and Electricity Markets Authority (“the Authority”), the regulator of the gas and electricity industries in Great Britain. This appendix summarises the primary powers and duties of the Authority. It is not comprehensive and is not a substitute to reference to the relevant legal instruments (including, but not limited to, those referred to below).

1.2. The Authority's powers and duties are largely provided for in statute (such as the Gas Act 1986, the Electricity Act 1989, the Utilities Act 2000, the Competition Act 1998, the Enterprise Act 2002 and the Energy Acts of 2004, 2008 and 2010) as well as arising from directly effective European Community legislation.

1.3. References to the Gas Act and the Electricity Act in this appendix are to Part 1 of those Acts.³⁶ Duties and functions relating to gas are set out in the Gas Act and those relating to electricity are set out in the Electricity Act. This appendix must be read accordingly.³⁷

1.4. The Authority’s principal objective is to protect the interests of existing and future consumers in relation to gas conveyed through pipes and electricity conveyed by distribution or transmission systems. The interests of such consumers are their interests taken as a whole, including their interests in the reduction of greenhouse gases and in the security of the supply of gas and electricity to them.

1.5. The Authority is generally required to carry out its functions in the manner it considers is best calculated to further the principal objective, wherever appropriate by promoting effective competition between persons engaged in, or commercial activities connected with,

- the shipping, transportation or supply of gas conveyed through pipes;
- the generation, transmission, distribution or supply of electricity;
- the provision or use of electricity interconnectors.
-

1.6. Before deciding to carry out its functions in a particular manner with a view to promoting competition, the Authority will have to consider the extent to which the interests of consumers would be protected by that manner of carrying out those functions and whether there is any other manner (whether or not it would promote competition) in which the Authority could carry out those functions which would better protect those interests.

1.7. In performing these duties, the Authority must have regard to:

³⁶ Entitled “Gas Supply” and “Electricity Supply” respectively.

³⁷ However, in exercising a function under the Electricity Act the Authority may have regard to the interests of consumers in relation to gas conveyed through pipes and vice versa in the case of it exercising a function under the Gas Act.

-
- the need to secure that, so far as it is economical to meet them, all reasonable demands in Great Britain for gas conveyed through pipes are met;
 - the need to secure that all reasonable demands for electricity are met;
 - the need to secure that licence holders are able to finance the activities which are the subject of obligations on them³⁸; and
 - the need to contribute to the achievement of sustainable development.

In performing these duties, the Authority must have regard to the interests of individuals who are disabled or chronically sick, of pensionable age, with low incomes, or residing in rural areas.³⁹

Subject to the above, the Authority is required to carry out the functions referred to in the manner which it considers is best calculated to:

- promote efficiency and economy on the part of those licensed⁴⁰ under the relevant Act and the efficient use of gas conveyed through pipes and electricity conveyed by distribution systems or transmission systems;
- protect the public from dangers arising from the conveyance of gas through pipes or the use of gas conveyed through pipes and from the generation, transmission, distribution or supply of electricity; and
- secure a diverse and viable long-term energy supply,
-
- and shall, in carrying out those functions, have regard to the effect on the environment.

1.8. In carrying out these functions the Authority must also have regard to:

- the principles under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed and any other principles that appear to it to represent the best regulatory practice; and
- certain statutory guidance on social and environmental matters issued by the Secretary of State.

The Authority may, in carrying out a function under the Gas Act and the Electricity Act, have regard to any interests of consumers in relation to communications services and electronic communications apparatus or to water or sewerage services (within the meaning of the Water Industry Act 1991), which are affected by the carrying out of that function.

1.9. The Authority has powers under the Competition Act to investigate suspected anti-competitive activity and take action for breaches of the prohibitions in the legislation in respect of the gas and electricity sectors in Great Britain and is a designated National Competition Authority under the EC Modernisation Regulation⁴¹ and therefore part of the European Competition Network. The Authority also has concurrent powers with the Office of Fair Trading in respect of market investigation references to the Competition Commission.

³⁸ Under the Gas Act and the Utilities Act, in the case of Gas Act functions, or the Electricity Act, the Utilities Act and certain parts of the Energy Acts in the case of Electricity Act functions.

³⁹ The Authority may have regard to other descriptions of consumers.

⁴⁰ Or persons authorised by exemptions to carry on any activity.

⁴¹ Council Regulation (EC) 1/2003.

Appendix 10 - Legal framework

Gas Act 1986

7.9. The Gas Act 1986 (the "Act") , and amendments to it, sets out the statutory framework under which the gas industry operates including the principal objective and general duties of the Authority. These were described in Appendix 8

European regulations

7.10. In addition to the regulatory framework set out under the Act, the gas industry is also subject to European and competition law. Section 4B of the Act provides that the duties imposed on the Authority under sections 4AA to 4A of the Act do not affect the obligation of the Authority to perform or comply with any other duty or requirement (whether arising under this Act or another enactment, by virtue of any Community obligation or otherwise). This would include the requirements in Directive 2009/73/EC and Regulation (EC) No 715/2009⁴², which came into force on 3 September 2009. The United Kingdom is required to implement the provisions of the Directive into national law by 3 March 2011. The Regulation will be directly applicable from 3 March 2011.

Impact assessment

7.11. Section 5A of the Utilities Act 2000 (Duty of Authority to carry out an impact assessment) applies where: (a) the Authority is proposing to do anything for the purposes of, or in connection with, the carrying out of any function exercisable under or by virtue of Part 1 of the Electricity Act or the Gas Act; and (b) it appears to it that the proposal is important, within the meaning set out in section 5A, but does not apply where the urgency of the matter makes it impracticable or inappropriate for the Authority to comply with the requirements of section 5A. Where section 5A applies, the Authority must either carry out and publish an impact assessment of the likely impact of the proposal or publish a statement setting out its reasons for thinking that it is unnecessary for it to undertake an impact assessment.

7.12. Section 5A(2) sets out the matters which would determine whether or not a proposal is "important" for the purposes of section 5A. These are where a proposal:

- g. Involves a major change in the activities carried out by the Authority;
- h. Has a significant impact on persons in the gas or electricity sectors;
- i. Has a significant impact upon persons engaged in commercial activities connected to the gas or electricity sectors;

⁴² We note of particular relevance to the proposals considered in this impact assessment a number of articles in Regulation (EC) No 715/2009. These are Article 13 (Tariffs for access to networks), Article 14 (Third-party access services concerning transmission system operators) and Article 16 (Principles of capacity-allocation mechanisms and congestion-management procedures concerning transmission system operators).

- j. Has a significant impact on the general public in GB or in a part of GB; and
- k. Has significant effects on the environment.

On 19 May 2010 we published our intention to conduct an impact assessment in our letter to NGG 'Modification Proposal to the Gas Transmission Transportation Charging Methodology, NTS GCM19R: Removal of NTS Daily Entry Capacity Reserve Price Discounts'.

Appendix 11 - Glossary

A

The Authority (Ofgem)

Ofgem is the Office of Gas and Electricity Markets, which supports the Gas and Electricity Markets Authority (GEMA), the body established by Section 1 of the Utilities Act 2000 to regulate the gas and electricity markets in Great Britain.

B

Baseline

Baselines define the levels of non-incremental entry capacity that the transmission licensee is obligated to release. Baselines also determine the levels above which incremental capacity is defined.

D

Day-Ahead Daily System Entry Capacity (DADSEC) auctions

This is the auction for Daily System Entry Capacity (DSEC) with allocations made one day before that capacity is available for use.

Daily Interruptible System Entry Capacity (DISEC) auctions

This is the auction for interruptible entry capacity. The amount made available is the Use-It-Or-Lose-It (UIOLI) amount (which is effectively unused capacity) plus any discretionary interruptible capacity that National Grid Gas (NGG) makes available in addition to this.

Daily System Entry Capacity (DSEC)

This is firm National Transmission System (NTS) entry capacity which allows the holder to flow gas on that particular day. It may be bid for at either the Day-Ahead Daily System Entry Capacity (DADSEC) auctions or the Within-Day Daily System Entry Capacity (WDDSEC) auctions.

F

Firm Entry Capacity

This is entry capacity which provides the user with firm entry capacity rights. In the event of a constraint National Grid Gas (NGG) cannot simply interrupt these users - it would have to buy these firm rights back from the user.

Incremental Obligated Entry Capacity

This is entry capacity in addition to the baseline (and previous signals of incremental entry capacity) which National Grid Gas (NGG) releases for allocation. Incremental

obligated entry capacity is capacity which has been signalled to be released as a result of a Quarterly System Entry Capacity (QSEC) auction.

Independent Gas Transporter (IGT)

IGTs are gas transporter licence holders that own and operate small local gas networks and levy distribution charges on shippers.

Interruptible Entry Capacity

This is entry capacity which does not provide the user with firm entry capacity rights. In the event of a constraint National Grid Gas (NGG) can remove the rights of holders of interruptible entry capacity to flow gas onto the National Transmission System (NTS).

M

Maximum Allowed SO Revenue

This is the maximum amount of revenue that National Grid Gas (NGG) is allowed to earn in its role as System Operator (SO). It is mainly comprised of amounts that NGG can earn from its performance in relation to a number of incentives.

N

National Grid Gas (NGG)

This is the licensed gas transporter responsible for the gas transmission system, and four of the regional gas distribution companies.

National Transmission System (NTS)

This is the high pressure gas transmission system in Great Britain.

Non-incremental Obligated Entry Capacity

This is the amount of entry capacity that that National Grid Gas (NGG) is obligated by its gas transporter licence to offer for sale less any obligations on NGG to release incremental obligated entry capacity resulting from Quarterly System Entry Capacity (QSEC) auctions. It is used interchangeably with the term 'baseline'.

Non Obligated Entry Capacity

This is entry capacity which National Grid Gas (NGG) makes available in addition to the levels of capacity it is obligated to make available for sale. These obligated amounts consist of non-incremental obligated entry capacity (i.e. baselines) and obligated incremental entry capacity.

O

Obligated Entry Capacity

This is the amount of entry capacity that National Grid Gas (NGG) is obligated by its gas transporter licence to offer for sale. This is the sum of non-incremental obligated entry capacity (i.e. baseline) plus incremental obligated entry capacity.

Q

[Quarterly System Entry Capacity \(QSEC\)](#)

Firm National Transmission System (NTS) entry capacity which may be bid for in the Quarterly System Entry Capacity (QSEC) auctions and registered as held by a user for each day in a particular calendar quarter. Entry capacity is sold forward via QSEC Auctions which offer capacity at each aggregate system entry point between two and sixteen years in advance.

R

[Reserve price](#)

At each auction for the sale of entry capacity (both firm and interruptible) a minimum price, or reserve price, is set which users must bid equal to or above in order to secure entry capacity.

[Rolling Monthly Transfer and Trade System Entry Capacity \(RMTTSEC\) auction](#)

This is the auction for Monthly System Entry Capacity (MSEC) with allocations made one month before that capacity is available for use. The MSEC capacity held allows a user to flow gas in each day in that particular calendar month.

S

[System Operator \(SO\)](#)

The System Operator (SO) has responsibility to construct, maintain and operate the National Transmission System (NTS) and associated equipment in an economic, efficient and co-ordinated manner. In its role as SO, National Grid Gas (NGG) is responsible for ensuring the day-to-day operation of the transmission system.

T

[Ten Year Statement \(TYS\)](#)

Special Condition C2 (Long Term Development Statement) requires National Grid Gas (NGG) to annually publish a ten-year forecast of National Transmission System (NTS) usage and likely developments that can be used by companies, who are contemplating connecting to the NTS or entering into transport arrangements, to identify and evaluate opportunities.

[TO allowed revenue](#)

This is the revenue that National Grid Gas (NGG) is allowed to collect for its role in owning the gas transmission network, the National Transmission System (NTS). The amount is set during the transmission price controls.

TO entry allowed revenue

This is the amount of TO allowed revenue that is collected from users entering gas onto the National Transmission System (NTS). It is collected from entry capacity charges and TO entry commodity charges. It is equal to 50 per cent of the TO allowed revenue after deducting metering and Distribution Network (DN) pensions related revenue.

Transmission Price Control Review 4 (TPCR4)

TPCR4 established the price controls for the transmission licensees and took effect in April 2007 for a 5-year period. The review applies to the three electricity transmission licensees, National Grid Electricity Transmission (NGET), Scottish Power Transmission Limited (SPTL), Scottish Hydro Electric Transmission Limited (SHETL) and to the licensed gas transporter responsible for the gas transmission system, National Grid Gas (NGG).

U

Uniform Network Code (UNC)

As of 1 May 2005, the UNC replaced National Grid Gas's (NGG's) network code as the contractual framework for the National Transmission System (NTS), Gas Distribution Networks (GDNs) and system users.

Use It Or Lose It (UIOLI) amount

This is the amount of unused entry capacity that National Grid Gas (NGG) under the Uniform Network Code (UNC) provisions must offer for release as interruptible capacity at the Daily Interruptible System Entry Capacity (DISEC) auctions. It is equal to the average unused capacity (i.e. entry capacity sold less capacity used to actually flow gas) over the previous 30 days.

W

Within-Day Daily System Entry Capacity (WDDSEC) auctions

This is the auction for Daily System Entry Capacity (DSEC) with allocations made on the actual day that capacity is available for use.

Appendix 12 - Feedback Questionnaire

1.1. Ofgem considers that consultation is at the heart of good policy development. We are keen to consider any comments or complaints about the manner in which this consultation has been conducted. In any case we would be keen to get your answers to the following questions:

1. Do you have any comments about the overall process, which was adopted for this consultation?
2. Do you have any comments about the overall tone and content of the report?
3. Was the report easy to read and understand, could it have been better written?
4. To what extent did the report's conclusions provide a balanced view?
5. To what extent did the report make reasoned recommendations for improvement?
6. Please add any further comments?

1.2. Please send your comments to:

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