

**CONSULTATION CONCLUSIONS
REPORT**

Consultation on the Proposed Entry
Capacity Transfer and Trade Methodology
Statement.

31st August 2007

Consultation Report on the Proposed Entry Capacity Transfer and Trade Methodology Statement.

Special Condition C8D of the Authority's proposals for National Grid Gas plc's Gas Transporter licence in respect of the NTS¹ (the "Licence") sets out obligations to prepare and submit for approval by the Authority entry capacity trade and entry capacity transfer methodology statements setting out the methodologies that National Grid NTS ("NG") will use to facilitate entry capacity trades and entry capacity transfers. In addition, NG is obliged to consult with relevant shippers and interested parties prior to submitting proposals to the Authority. NG considers that it is appropriate to prepare a single document to meet these proposed obligations.

On 2nd May 2007 NG issued proposals for the Entry Capacity Transfer and Trade Methodology Statement ("T&T"). NG invited views in respect of these proposals to be made by 30th May 2007. Representations were received from nine respondents. These representations can be found on NG's web-site at <http://www.nationalgrid.com/uk/Gas/Charges/statements/transportation/ecttms/>. At the conclusion of the consultation NG considered that it could not submit a proposal for the T&T to the Authority for approval for two reasons:

- It was expected that further development of UNC processes in associated UNC modification proposals would have required later adjustment to the methodology; and
- Continued consultation on the form of the Licence meant that the Authority had no means to approve the methodology statement.

Thus NG did not publish a consultation report.

Following further industry workstream meetings, on 30th July 2007, NG issued revised proposals for the T&T inviting views in respect of these proposals to be made by 28th August 2007. Representations were received from three respondents;

- E.ON UK plc ("Eon") did not specifically state whether or not they support the proposal;
- Statoil (UK) Limited ("Stuk") who are "unable to support"; and
- EdF Energy ("EdF") who provided support "for this winter only".

This consultation report provides a summary of the representations received, NG's response to specific issues and an indication of whether changes have been made to the T&T as a result. The full representations can be found on the web-site given above.

UNC modification proposal 156² has been raised to support the principle and process for entry capacity transfer and trade. Reference should be made to them and the modification reports for details of the UNC processes. The T&T supports the Licence and UNC modification proposals in defining the methodology for determining entry capacity transfer and trade exchange rates. In order to become effective it assumes that the Licence has been agreed and an appropriate UNC modification proposal approved and implemented.

At the time of preparing the proposed T&T agreement had not been reached on the detail of the Licence. The proposed statement was drafted on the basis of the Section 23 notice.¹ Should the specific conditions relating to entry capacity transfer and trade be significantly at variance with NG's expectations, or modification proposal 156 (and its alternatives) be rejected, then NG may amend or withdraw its proposed T&T.

¹ Notice under section 23 (3) of The Gas Act 1986, Ofgem ref 195/07 – dated 30/07/07.

² UNC modification proposal 0156: Transfer and Trading of Capacity between ASEPs and the alternatives 0156A and 0169 raised by EOn.

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Party	Issue	Response Quotes	National Grid NTS Response	Proposed changes
1 – General				
Eon	1.1: Complexity and Transparency	Many of our concerns relate to the lack of transparency associated with the proposed arrangements and we believe that any enduring solution must place transparency and simplicity at the top of the agenda.	<p>NG agrees that greater transparency and simplicity could be issues for discussion in respect of an enduring solution.</p> <p>NG has developed, in good faith, a methodology to meet the pressing needs of the industry. A key licence obligation for NG is to avoid material increases in costs (see 2.1 below). In order to satisfy this requirement whilst maximising capacity available for transfer, NG needs the flexibility to undertake its analysis under the most appropriate conditions.</p> <p>To assist users in understanding the effect of the methodology NG has provided additional information. As the transfer and trade process is implemented and progresses NG will consider whether further supporting information would be helpful.</p> <p>Hence, given the timescales available NG believes that the methodology, with the provision of supporting information, realises a suitable level of detail and is fit for purpose.</p>	<p>None.</p> <p>Issue for consideration in developing an enduring solution.</p>
Stuk	1.2: Overall impact	Whilst we understand that a number of shippers have expressed concern that their ability to flow capacity at certain entry points has been reduced and, as such, a mechanism needs to be put in place for this winter to alleviate the problem, without a full impact assessment, the changes proposed could result in greater detriment to the system than a 'do nothing' approach.	NG appreciates the concerns expressed. However, NG has a Licence obligation to develop a methodology to facilitate entry capacity transfer and trade. NG believes that the proposed methodology ensures that reasonable levels of capacity can be transferred without material increase in cost (i.e. constraint management actions).	None
Stuk	1.3: Timing / industry consideration. proposing urgent modifications to the UK Entry Regime, without giving the industry sufficient time to fully consider the impacts of those proposals, risks	The proposed Licence places an obligation on NG to submit to the Authority, for approval, the methodology statement. This is required "by the date on which the Authority issues a decision giving effect to this licence	None

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		creating uncertainty and instability in the market, ahead of this winter, which could ultimately prove detrimental to security of supply. This uncertainty remains an issue, with this methodology statement. Given that there are several Modification Proposals still under consideration, one would expect that this methodology may need to be amended, depending on which proposal is implemented. Moreover, the licence changes have not yet been finalised and so this methodology statement remains subject to further changes.	condition, or such other date as the Authority may otherwise direct". Hence, as it is obliged to consult on its proposed T&T methodology, NG has had to develop the methodology in parallel with UNC modification proposals and the Licence consultation. The proposed T&T methodology has been developed to be consistent with current live UNC proposals and the Section 23 notice.	
EdF	1.4: As above concerned with the process and lead times that have lead to the raising of this methodology statement.....little foresight or consultationhas created a significant regulatory risk to the industry.	See above	None
EdF	1.5: Acceptability for enduring solution.	we do not believe that this represents an enduring solution, and have significant concerns over the following areas: <ul style="list-style-type: none"> • Use of zonal and nodal maximum capabilities. • The use of demand assumptions minimum historical demand for the month in question. • Complexity. this is extremely complex. 	These issues can be discussed and developed as part of the process to advance an enduring solution.	None. Issues for consideration in developing an enduring solution.
2 – Material increase in costs				
Eon	2.1: Definition of "material".	lack of a precise definition of "material increase" restricts the extent to which the methodology can be assessed objectively and replicated by Users. in the absence of a precise definition, an overly conservative approach could be adopted by NG NTS, resulting in small amounts of capacity being moved	Given the discussions that took place in relation to the Licence we believe it would be inappropriate to quantify materiality in the Transfer and Trade Methodology Statement. Set out below is how the issue of materiality has, therefore, been considered in the methodology.	None

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		<p>this winter. 'material increase' has long been a contentious area of the draft Transporter licence, we believe that on-going uncertainty around what it <i>actually</i> means both for NG NTS and Users could be resolved by a Licence definition or quantification.</p>	<p>NG is obliged to avoid material increases in costs. The most significant likely cost is that of capacity buy-backs (see 2.2 below) which can run into millions of pounds.</p> <p>NG considers that it would be in conflict with the obligation to facilitate transfer and trade if it were to reduce the probability of additional buybacks (and hence incremental costs), resulting from transfers and trades, to zero. Therefore, in accordance with the methodology, NG will identify supply scenarios, based on historic and potential future supply patterns, with a low, but not zero, (e.g. approximately 5%) probability of occurring. Thus NG has avoided using extreme (overly conservative) conditions where the likelihood of observed conditions would be zero or highly unlikely because this would have severely restricted the potential for capacity transfer. Instead NG has accepted what it believes is a reasonable probability.</p> <p>The combination of:</p> <ul style="list-style-type: none"> a) a low (but not zero) probability of incurring significant buy-back costs; and b) the possible level of buy-back costs; <p>satisfies, in NG's opinion, the obligation to avoid material increases in costs. However, it should be recognised that the scenarios adopted by NG do not eliminate totally the possibility of significant costs being incurred.</p>	
Eon	2.2: Elements of increased costs.	<p>It would be more helpful if the methodology described exactly which costs (or risks) are being assessed and in what context. For example, if the mechanism caused additional compression to be needed then there could be an increase in costs to NG NTS; however, the benefit to the market of additional gas delivery may outweigh the compression cost.</p>	<p>Paragraph 16 clarifies that the methodology assesses the expected cost and risk of constraint management actions. Although a number of operational actions can be defined as "constraint management" the cost of capacity buy-backs, if incurred, could be significantly greater than all other operational costs.</p> <p>In order to maximise system capability and available capacity for transfer NG assesses the system at its limits, i.e. with compressors operating at full output and 100% availability. Hence, in order to produce a methodology in time for the coming winter, compressor costs have not been used as a limiting factor.</p> <p>In regard to an enduring solution NG may wish to consider specifying costs, other than those relating to capacity buy-</p>	<p>None.</p> <p>Issue for consideration in developing an enduring solution.</p>

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			backs, in the methodology.	
Stuk	2.3: Increased likelihood of buy-backs.	<p>STUK's primary concern is the risk of increasing the likelihood of buy-back requirements. The methodology states that, when undertaking the TBE Base Case Analysis for winter 07/08 'a simplifying assumption may be used, i.e. that an incremental forecast system failure...would result in a material increase in costs'.</p> <p>This fails to give market participants an appropriate level of confidence that it would prevent increasing the risk of buy-backs and potentially Terminal Flow Advices (TFAs) at a 'recipient' ASEP. Without this, there is the potential for those Users, which have already booked their long-term capacity requirements to be curtailed, owing to gas being transferred to that ASEP, which cannot physically be accommodated.</p>	<p>NG's assumption is that if the enactment of a capacity transfer were to increase the likelihood of the system being unable to satisfy obligated capacity levels then this would be considered to be a material increase in costs (see also 2.1 above) and hence should not be allowed to happen.</p> <p>NG believes that this assumption should give comfort that there should not be a significant increase in the risk of buy-backs and TFAs. However, NG has not taken an extremely cautious approach as to do so may result in very low (or zero) quantities of capacity available for transfer. This would be inconsistent with the Licence requirements.</p> <p>NG recognises that if constraint management actions are taken the impact may be felt by all Users at all ASEPs irrespective of through which mechanism capacity was obtained. Firm capacity obtained through transfers and trades should not have inferior rights to capacity obtained in other auctions so it is to be expected that any buy-backs and TFAs may apply equally to capacity bought in long term auctions.</p>	None
3- Zonal Area Maximum				
Eon	3.1: Use of baseline values	<p>more transparent and auditable if the ZAM is set at the zonal baseline.</p> <p>If this approach materially increases its buy-back risk relative to the assumptions used in setting the TPCR, then an adjustment could be made to the buy-back incentive.</p>	<p>It may be simpler to set the ZAM at the aggregate of the baselines of the ASEPs in the zone. However, with the ZAM set at baseline levels an exchange rate of 1:1 would not meet the obligation to avoid material increases in costs. Although ASEPs within a zone use common parts of the system they are not fully interchangeable to the extent that individual SEPs generally are within an aggregate SEP. Hence the ZAM needs to be based on physical capability not commercial / regulatory values.</p>	None
Eon	3.2: Test scenarios	<p>Paragraph 31(ii), the ZAM is likely to be determined by test scenarios. It is not clear how extreme will these test scenarios be. There appears to be a lack of transparency in respect of what NG</p>	<p>See also 1.1 above.</p> <p>These test scenarios are supply patterns that NG believes are reasonably likely to occur based on previous flow patterns and other available information. In accordance</p>	None

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		NTS will assume here	with 2.1 they are not extreme scenarios so take an appropriate balance between reducing the probability of incurring costs and limiting the ZAM. Given the timescales available NG believes that the methodology, with the provision of supporting information, realises a suitable level of detail. Increased transparency could be considered as part of an enduring solution.	
4 – Nodal Allocation Maximum				
Eon	4.1: Setting the CAP on the NAM	<p>We strongly believe that the proposed cap of 150% of obligated entry capacity (paragraph 20 (a)) should be removed. arbitrary, unproven figure inconsistent with the aim and objectives to facilitate the efficient and economic re-allocation of entry capacity to where it is valued most. Ultimately, the imposition of an artificial cap will place a constraint on the total amount of capacity that can be transferred</p> <p>If the cap is being used to control buy-back risk, then it would seem much more economic and efficient to base the NAM purely on actual network analysis and modelling. The explanation in the methodology for the use of the 150% figure is that this is used in the QSEC auctions as ‘the default maximum percentage of existing obligated entry capacity available for Users to signal their requirement for incremental demand’. However, as NG NTS will be aware, the ‘150%’ used for the QSEC is a default figure in the IECR which is not fixed and can be changed at the request of Shippers. We therefore fail to see any justification for the imposition of the 150% cap. If the 150% cap has been agreed with Ofgem as part of the TPCR package</p>	<p>The appropriateness of a cap could be considered as part of the development of an enduring solution. However, for the coming winter NG considers that it is reasonable to apply a cap to limit the need for unnecessary analysis work.</p> <p>Eon rightly point out that the 150% cap on incremental capacity requests is a default figure for the QSEC auction that can be over-ridden. NG considered this level to be a sensible cut-off point for analysis for transfer and trades and issued information using this cap to the transmission workstream on 5th July. NG has not been made aware, through this consultation or otherwise, of users needing to transfer greater quantities.</p> <p>Eon state that the imposition of an artificial cap will place a constraint on the total amount of capacity that can be transferred. However, the NAM is used to set an absolute maximum on the quantity of capacity that can be accepted at an ASEP. As NG has gained understanding of the outcome of applying the methodology it has become aware that, in reality, the NAM is unlikely to limit that quantity of capacity that can be transferred to the recipient ASEP. It is more likely to be the ZAM or the quantity of surrendered / unsold capacity that is the limiting factor.</p>	<p>None.</p> <p>Issue for consideration in developing an enduring solution.</p>

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		then this should be made clear in the consultation. If not, we would welcome additional analysis and evidence on the suitability of the 150% figure.		
Eon	4.2: Setting the NAM	<p>Paragraph 20 (a) Use of the minimum historical demand for a month may cause the method to be driven by exceptional circumstances. We suggest that minimum demand for a typical month / seasonal nom will give more consistent and predictable results.</p> <p>where flow has historically been above the NAM then the NAM could be increased to that flow, unless other constraints are reached.</p> <p>Paragraph 20 (b). We do not support the proposal to limit the NAM to the max historical flow from the last five years</p>	<p>The NAM is used to set the final limit on capacity at an ASEP if the transfer and trade methodology facilitates unexpectedly high quantities to be transferred to a particular ASEP.</p> <p>Paragraph 20 a) sets out a practical way to determine the NAM subject to any limits identified under 20 b). The criteria described in the methodology define conditions which reduce the risk of extremely high NAMs being set (which would result in breach of the requirement to avoid material increase in costs). NG accepts that, following experience over the coming winter, the approach may be refined, but believes that the approach taken offers a workable solution without creating undue constraints (if any) on potential capacity transfers.</p>	None.
Eon	4.3: Confidentiality	<p>we are concerned by the suggestion that these limits [historical flows] are also confidential. Where the constraint is within the terminal itself, that constraint should be managed by the terminal operator through the contractual arrangements it has with Shippers to use that terminal. Where the constraint is an NTS constraint, we would question why that should be confidential?</p>	<p>Where NG is aware of a physical, safety or contractual limit that would mean that the NAM (calculated in accordance with paragraph 20 a)) cannot be honoured, the historical maximum will be used (unless this is above the identified limit).</p> <p>The methodology does not state that historical maxima are confidential. It is the identified limit (usually recorded in the NEA / SCA) that will be confidential. Hence the historical maximum is used as an alternative to the confidential (NEA) information.</p>	None.
5 – Definition of Zones.				

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Eon	5.1: East coast zone	Reference to the use of an east coast “super zone” has been frequently made in recent entry capacity baseline review meetings. If this zone was used to set current baselines, upon which trade and transfer is based, then we are unclear why such a “super zone” was not also adopted for trades and transfers? The use of a single east coast super zone could reduce significantly the number of exchange rates and combinations for inter-zone transfers and aid clarity in terms of intra-zone transfers. This however, is clearly a very significant change to the proposed methodology so is perhaps better addressed through the longer-term enduring arrangements.	NG agrees that the concept of an east coast “super zone” would be a very significant change to the proposed methodology. We would therefore, agree that this suggestion should be considered for the long term enduring arrangements.	None. Issue for consideration in developing an enduring solution.
6 – Security of Supply				
Stuk	6.1: Short term markets	<p>...reducing available capacity at ASEPs within a zone to a Maximum Permitted Flow Level (MPFL), to provide additional units at a ‘recipient’ ASEP will reduce the capacity available in future short term auctions, thereby reducing market participants’ ability to optimise their position in the short term, and as a result, reducing the flexibility in the short-term market and the ability to respond to increases in demand.</p> <p>Storage facilities risk losingflexibility to respond to price spikes mid winter if the capacity is unavailable in the short-term market. The only way to mitigate such risk would be to book long-term capacity, which may fail to reflect a User’s actual requirements and, therefore, lead to inefficient operation of the system and increase costs. A further unintended</p>	<p>An intention of the capacity transfer and trade mechanism is to maximise the availability of capacity where Users value it most and to avoid sterilisation of capacity. Hence, if the capacity is not booked at a particular ASEP but is demanded at another, it is appropriate that NG seeks to facilitate providing the entry capacity at the point where it is demanded.</p> <p>Near the day, if it is clear that entry capacity is not being used at a particular ASEP, NG has the ability (under the current arrangements) to release amounts of capacity above the prevailing obligated level (on either an interruptible basis or on a discretionary basis in the form of non-obligated entry capacity).</p>	None

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		consequence might be where gas is transferred to Teesside, for example, reducing the MPFL at St Fergus. Market factors may lead to the LNG gas being shipped outside of the UK and yet the gas, which would otherwise have been available in the short-term auctions, becomes stranded at Teesside.		
EdF	6.2: Security of Supply	this methodology will make additional capacity available at the ASEPs where it is required.....so help to improve the UK's security of supply position..... movement towards zonal and nodal capabilities should also help to ensure no constraints occur on the system	Security of supply is dependent, amongst other factors, upon a diversity of supplies as well as the absolute quantity of available capacity at individual locations. The Transfer and Trade methodology is intended to facilitate the relocation of capacity to ASEPs where it is most valued, but as can be seen in issue 6.1 above, there is an alternative view that Transfer and Trades may have a detrimental effect.	None