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24 November 2006

Dear Paul,

Response to Consultation on the Exit Capacity Release Methodology Statement in respect of proposed Enduring Gas Offtake Arrangements

This response is on behalf of National Grid's distribution business.

Section 1: NTS Exit (Flat) capacity

Firstly, we do not support either of the options proposed since the cost of NTS offtake rights would not be known until after the commitment is made, leading to inefficiency and potential uneconomic decisions. We have therefore suggested an Option 3 where rights are made available at definitive prices at the time of commitment.

Of the two options proposed in the ExCR, we favour Option 2 because this offers the User some possibility of rebalancing its Prevailing Exit Capacity holdings if faced with substantial price increases at some offtakes, by reducing its Prevailing Exit Capacity at some offtakes and increasing it at other offtakes, before the end of the four year period automatically applied under Option 1. However, we consider that Option 2 gives only very limited extra flexibility relative to Option 1, since the prevailing exit prices paid for the capacity would have to rise by an average of over 33% over the first three years relative to the price used for the four year commitment in order to allow the user to bring forward the time when a capacity decrease is allowed. Under Option 2 the User is thus exposed to paying up to 133% of the expected price in the first three years and an unlimited price in the fourth year without any possibility of reducing its capacity holdings over the four years, which were committed to on the basis of much lower prices. We consider that this level of exposure, and the unlimited price exposure under Option 1, is unacceptable.

Option 2 could be made a bit more flexible, by allowing the minimum commitment to be met over any number of months, rather than only over whole years, with the reduction in holdings allowed at times other than October. Thus if the minimum commitment was expected to be met over, say, 37 months then rather than still having to wait until the end of the four years to reduce the holding, the holding could be reduced from month 38 of the original four year commitment, so long as appropriate notice was given.

However, we consider that this modified Option 2 still has major drawbacks. For a DN User, the uncertainty around the price that will actually be paid for the exit capacity is a major disadvantage since the DN will be aiming to make an efficient and economic trade-off between purchasing DN interruption rights or investing in the DN system and purchasing NTS offtake rights. This decision-making will be made in gas year Y when, under the DN Interruption reform proposals, the potential cost of DN Interruption rights for the medium term period (Y+4 to Y+8) would be known but, under either of the options proposed, the potential cost of NTS offtake rights would be unknown until shortly before the year of application. This is likely to lead to inefficiency in the decision making.

To overcome this problem we suggest a new option, Option 3, for the release of NTS offtake capacity, whereby the NTS provides a definitive price for the prevailing offtake capacity rights at year Y to Users and Users commit to paying this price for the four years Y+4 to Y+7 for this level of capacity. This provides a high degree of cost certainty to Users (subject to other charging adjustments to enable NTS to recover the price control level of TO revenue), allows efficient trade-off decisions for the DNs and other Users, and gives NTS revenue certainty relating to the capacity commitment at the time when it will be making its investment decisions.

In each year, the price for committing to capacity for years Y+4 to Y+7 would potentially change, reflecting NTS' latest estimates, so that if additional prevailing capacity for, say, initial year Y+7 is committed to in the following year (when it is Y+6) the capacity commitments for the year would be at varying, but known, prices. Although this introduces varying prices for different tranches of prevailing capacity held for a particular year, this billing complexity is already present in the proposals since annual and daily NTS exit (flat) capacity would be sold through auctions at varying prices.

Section 2: NTS Exit (Flexibility) capacity

We support the principles and general basis on which it is proposed that NTS exit (flexibility) capacity will be made available, subject to the definition of flexibility capacity being agreed. However, we note that further detail of the auction and daily application processes are required in order to fully evaluate the proposal.

If you have any queries, or would like to discuss this response, please do not hesitate to contact me.

Yours sincerely,

Steve Armstrong