

IN THE HIGH COURT OF JUSTICE

QUEEN'S BENCH DIVISION

ADMINISTRATIVE COURT

B E T W E E N:

THE QUEEN

on the application of

(1) EXCELERATE ENERGY LIMITED PARTNERSHIP

(2) SEAL SANDS GAS TRANSPORTATION LIMITED

Claimants

- and -

GAS AND ELECTRICITY MARKETS AUTHORITY

Defendant

STATEMENT OF GROUNDS FOR JUDICIAL REVIEW

A. INTRODUCTION

- 1** These proceedings concern decisions and omissions by the Gas and Electricity Markets Authority ("GEMA") which have the practical effect of preventing the proper operation of the Claimants' new gas import facility at Teesside, the Teesside GasPort.
- 2** The decisions and omissions concern the entry arrangements for the gas National Transmission System ("NTS") which is operated by National Grid Gas ("NGG").
- 3** The Claimants built the GasPort at Teesside, with the encouragement both of GEMA and the Department of Trade and Industry ("DTI"), because the Teesside entry point to the NTS had

ample baseline entry capacity to accommodate the GasPort's requirements. GEMA and NGG both knew of the capacity requirements of the GasPort.

- 4 But on 30 March 2007 GEMA implemented modifications to NGG's NTS Licence which more than halved the baseline entry capacity at Teesside – from 761 GWh/day (GigaWatt hours per day) to 361 GWh/day. The new baseline at Teesside is intended to be in effect for the entire period from 1 April 2007 to 31 March 2012. The requirements of the GasPort cannot be accommodated within the reduced Teesside baseline entry capacity.
- 5 Meanwhile, GEMA has also failed to ensure that any arrangements are in place to transfer capacity between NTS entry points. These transfer arrangements were an integral part of the Transmission Price Control Review ("TPCR") package which GEMA agreed with NGG. They should have been introduced on 1 April 2007, at the same time as the baseline capacity reduction. But they still have not been introduced, and the detail of how they will work in practice is still not known.
- 6 On 12 June 2007, GEMA decided that proposals (separately raised by NGG and by E.ON UK plc) to amend the NTS Uniform Network Code ("UNC") to introduce transfer arrangements should not be implemented.
- 7 GEMA has also failed to ensure that NGG carried out its undertaking, given to GEMA on 4 May 2007, to introduce revisions to the interruptible capacity regime to satisfy the requirements of the GasPort at Teesside this winter.
- 8 The effect of all this is to leave the GasPort currently stranded with no effective way to input gas into the NTS. This is a serious injustice. The GasPort was built at a cost of £40 million with the full knowledge and encouragement of GEMA and the DTI.
- 9 The Claimants have endeavoured to work with GEMA and industry parties to find a solution. But the Claimants still have no security that any workable solution will be implemented. The details of how the proposed transfer arrangements or alterations to the interruptible regime will work in practice are not known. The Claimants have no security that any of these proposals will actually enable the GasPort to operate as planned. The Claimants apply for permission to bring this judicial review as a last resort.

B. BACKGROUND AND FACTS¹

GEMA

- 10 GEMA was established under section 1 of the Utilities Act 2000 as the regulator of the gas and electricity industries. Ofgem is the office of GEMA. GEMA is subject to statutory duties, in particular under section 4AA of the Gas Act 1986 (“the Gas Act”), and to duties under EU law, as described below.

The Gas National Transmission System

- 11 The NTS is owned and operated by NGG under a licence treated as granted under section 7 of the Gas Act (“the Licence”). NGG is the monopoly operator of the gas NTS. NGG owes duties under Section 9 of the Gas Act, under the Licence and under EU law, as set out below.

NTS Entry arrangements, the Licence and the UNC

- 12 The arrangements under which shippers introduce gas into the NTS (“entry arrangements”) are set out partly in the Licence and partly in documents issued under the Licence – for example the UNC, which is issued under Condition A11 of the licence.
- 13 The NTS entry capacity baselines are specified in Table A2 of Schedule A to the Licence. They are the baseline amounts of capacity at each entry point on the NTS that NGG is obliged to release for sale. Baseline capacity is allocated to individual gas suppliers in quarterly, monthly, daily and interruptible daily blocks through various auctions.
- 14 The Licence (including the baseline amounts of capacity specified in Table A2) may be modified by GEMA with the consent of NGG as licensee under section 23 of the Gas Act. Before any such modification is made, GEMA is required by section 23(3) and (4) to publish a notice of the proposed modifications, with reasons, and to consult on it.
- 15 Up to 1 April 2007, the entry capacity baseline for Teesside in Table A2 was 761 GWh/day. GEMA’s decision on 30 March 2007 to reduce this to 361 GWh/day was taken under section 23 of the Gas Act.

¹ The factual background is set out in the witness statement of Robert Bryngelson. This section of the Grounds reproduces the contents of paragraphs 5-78 & 87-98 of Mr Bryngelson’s witness statement.

- 16 The UNC may be modified under the procedures in Condition A11. These require a proposal by a gas shipper or gas transporter, consultation, a recommendation by the UNC Panel, and a final decision by GEMA. There is also a procedure for urgent modifications.

Excelerate, EBRVs and the Teesside GasPort

- 17 Excelerate Energy Limited Partnership (“Excelerate”) was founded in 2003. It is an innovative Liquefied Natural Gas (“LNG”) shipper and marketer.
- 18 Excelerate currently controls and operates three purpose built Energy Bridge Regasification Vessels (“EBRVs”). Five more EBRVs are currently under construction or on order for Excelerate – these are expected to start entering into service between 2008 and 2010. EBRVs are able both to transport LNG and also to regasify it aboard the vessel.
- 19 Excelerate commissioned the construction of the GasPort at Teesside to accommodate its EBRVs and enable them to supply the UK gas market. The Second Claimant (“Seal Sands”) is a wholly owned subsidiary of Excelerate. The majority of the Teesside GasPort is in the process of being sold by Excelerate to Seal Sands. Excelerate retains the right to use the GasPort.
- 20 LNG is produced by cooling natural gas to temperatures of approximately -160°C. This process liquefies the gas, and reduces its volume by about 600 times. This allows for the natural gas to be shipped economically across the globe in LNG vessels such as the EBRVs. Ordinarily, LNG is then regasified (by being warmed) at a dedicated land-based plant before being transported into a high pressure gas network such as the NTS.
- 21 Building a conventional land-based infrastructure to receive LNG, store it until needed, and then regasify it into natural gas is expensive, time-consuming and often raises substantial environmental and safety concerns.
- 22 The EBRVs provide an answer to these difficulties. They contain onboard regasification equipment which is able to convert LNG into high pressure gas and deliver it directly into a standard gas transmission pipeline. The shore-based infrastructure required is far less than for a traditional LNG regasification facility (which is needed for standard LNG vessels) and can be constructed quickly, at less cost and with less environmental impact. The EBRVs can

also operate as standard LNG vessels, delivering their cargo to an ordinary onshore LNG regasification plant.

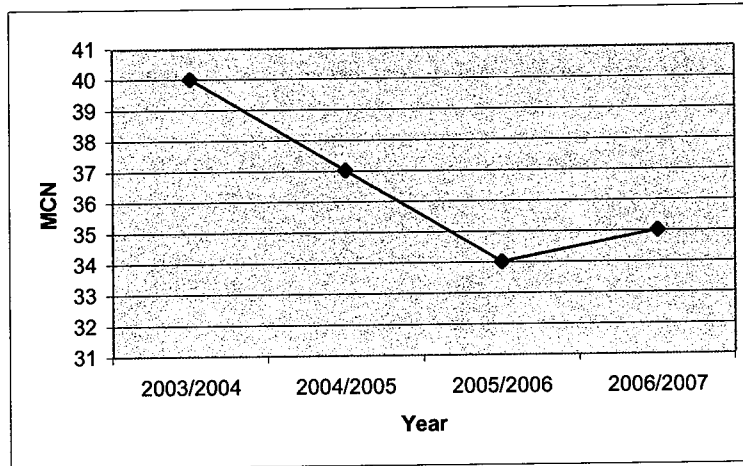
- 23 Excelerate's first docking facility was constructed offshore in the Gulf of Mexico and is known as "Gulf Gateway". It allows EBRVs to dock offshore, convert LNG into natural gas and deliver it directly into an offshore pipeline where it is transported onshore to customers. A further similar facility is being constructed offshore of Boston, Massachusetts (the "Northeast Gateway").

The GasPort and Teesside NTS Entry Capacity

- 24 The Teesside GasPort, which Excelerate commissioned, is the world's first dockside LNG import natural gas delivery facility. The Teesside GasPort is designed to receive high pressure natural gas from the EBRVs and transmit it to the NTS, the UK's gas national grid. Planning permission for the GasPort was granted in August 2006. In February 2007 construction of the GasPort was substantially completed and the GasPort was commissioned. The initial shipment of LNG arrived in Teesside in February 2007 - the EBRV docked, regasified part of the LNG on board and pumped natural gas through the GasPort. Following the addition of nitrogen using the GasPort's facilities, the gas was transmitted through the NTS to customers.
- 25 The construction cost of the GasPort was approximately £40 million and included the refurbishment of a jetty to handle the EBRVs, the construction of a loading arm, the construction of nitrogen blending facilities and the laying of approximately 6.5km of high pressure pipeline (including a 1 km section under the River Tees) to link the GasPort to the NTS.
- 26 Teesside was chosen for the GasPort because it has deep water port facilities and an existing entry link to the NTS which had (at the time) ample unused baseline entry capacity to accommodate the GasPort's requirements.
- 27 When an EBRV docks at the GasPort, it takes approximately 5 to 7 days for it to regasify its LNG cargo and deliver it to the NTS. An EBRV holds around 85 million of cubic metres of gas, and can offload natural gas at a maximum rate of 11.3 to 17 million cubic metres of gas ("MCM") per day. The three EBRVs which are currently in service typically take 7 days to offload, and would require entry capacity to the NTS of 11.3 MCM per day during this

period. The five EBRVs currently under construction or on order are designed to have an enhanced performance. These vessels can offload in as little as 5 days, and will require entry capacity to the NTS of 16.5 MCM per day during this period. These vessels are due to enter service at varying dates from 2008 through 2010.

- 28 When Excelerate took its decision to commission construction of the GasPort at Teesside, the Teesside entry point to the NTS had a baseline capacity of 761 GWh/day – this is equivalent to 70 MCM of gas per day. Peak gas flows at Teesside had declined from around 40 MCM in 2003/2004 to around 34 MCM in 2005/2006. This was due in part to declining North Sea oil and gas production, and the consequent drop in the gas flow from the North Sea into the NTS at Teesside.
- 29 The baseline capacity of 70 MCM at Teesside, together with the decline in peak gas flows, left very substantial headroom for the operation of the GasPort.
- 30 Excelerate’s decision to construct the GasPort at Teesside was taken in reliance on assurances by NGG that there was ample entry capacity to the NTS available at Teesside. In response to a request to confirm the capacity position, NGG informed Excelerate on 5 October 2005 [7/56-57]: *“From an NTS perspective there is considerable available capacity at Teesside both physically and in today’s world more importantly commercially as existing Teesside capacity is a massive 761 GWh/d (approximately 70 mcm/d). Hence from our perspective most if not all issues are ‘upstream’ of NTS entry. Historically entry flows at Teesside have been as high as 45 mcm/d, current forecasts for 2006/7 are below 30 mcm/d.”*
- 31 The following graph and table show the baseline capacity and the declining peak gas flows at the Teesside NTS entry point between 2003/04 and 2006/07:



Terminal	Baseline		Maximum gas flows (MCM)			
	GWh/d	MCM	2003/2004	2004/2005	2005/2006	2006/2007
Teesside	761	70	40	37	34	35

32 Excelerate was aware of a number of possible sources of new gas at Teesside - a proposed traditional LNG terminal, operational from 2011/12, a significant new gas field discovered by BG in 2006, and a possible connection to the Norwegian sector. However none of these projects was certain to come to pass, and further drops were expected in UK gas production flowing to Teesside. Excelerate understood that the flows from the GasPort and from any potential new source of gas at Teesside could readily be accommodated within the available entry capacity at Teesside.

The GasPort and energy markets

33 Excelerate decided to build the GasPort at Teesside because it identified a market opportunity to provide gas to the UK during periods of high demand, in particular in the winter. Until recently, the United Kingdom has been a net exporter of natural gas. The reserves in the UK

continental shelf have amply met the UK's natural gas needs. However, UK production peaked in the year 2000 and is now in decline whilst demand for natural gas continues to rise. Excelerate commissioned the construction of the GasPort to assist in closing the gap between supply and demand, hoping to benefit from the higher gas prices that a supplier that meets peak demand needs can achieve. It is forecast that UK will import around 60% of its gas needs by 2010.

- 34 Excelerate's business model for the Teesside GasPort is to use the EBRVs to ship gas to the places where and when it is most needed. Excelerate's business is highly flexible. Excelerate buy gas on spot markets and the EBRVs are routed (often at very short notice) to the delivery point where it can command the best price. Excelerate responds to market price signals, providing gas to where the users need it most. Its business is to deliver gas to meet peaks in demand worldwide.

The DTI and Ofgem supported the GasPort

- 35 The Teesside GasPort was welcomed and encouraged both by the Department of Trade and Industry ("DTI") [28/48, 29/489 & 66/874-876] and by Ofgem [11/127-128, 15/223-226, 17/234-235 & 25/441-442].
- 36 The planning process for the GasPort was relatively smooth (despite it being adjacent to protected environmental areas), given the support Excelerate had for the project from the Department of Trade and Industry, Ofgem and local industrial gas users, all of whom explained that the UK had an urgent need for new gas import facilities [17/229-238, 28/480-482 & 29/483-510]. As the report to the planning committee noted, the GasPort project was strongly supported by local industrial users, NGG and Ofgem because of the security of supply benefits that it could bring:

Any decision not to proceed with the GasPort Project has implications for short-term energy supply at several levels. Locally, there is a risk of winter 2006/2007 energy supply problems for several key local industrial consumers. This risk is reflected in the provision of clear support for the GasPort Project from several key industrial stakeholders, including Terra Nitrogen, Bio fuels Corporation Plc, National Grid, Ofgem and the Major Energy Users' Council. At a more strategic level, a decision not to proceed with the GasPort Project has the potential to result in supply

shortfalls and energy price increases during the 2006/2007 winter and subsequent years (emphasis added) [29/491].

- 37 As the project progressed, Excelerate sent Ofgem regular progress reports (such as the examples at [19/282-285, 23/380-438, 24/439-440 & 25/441-442]), and also made a presentation to GEMA about the project, in which it set out the GasPort's "key characteristics" including the ability to "deliver... 11.3 million cubic metres per day [122 GWh/day] with expansion to 600 mmcf/d from 2008" [27/459-479].
- 38 Ofgem and NGG were fully aware of the GasPort's entry requirements at Teesside (including the requirements when the new EBRVs enter service in 2008). They knew that the GasPort had been located at Teesside because there was ample headroom within the Teesside entry capacity baseline to accommodate the GasPort's requirements. They encouraged Excelerate in this belief.
- 39 The Secretary of State for Trade and Industry, Alistair Darling M.P., made an official visit to the GasPort on 14 February 2007 [66/874-876]. He confirmed the Government's support for the GasPort as a means of increasing energy security and as an example of the effectiveness of the UK regulatory regime. He described the GasPort as a "world first" and said that it "is helping Britain lead globally in diversifying energy supply". The DTI press release stated:

WORLD FIRST FOR GIANT SHIP DELIVERING INCREASED ENERGY SECURITY FOR BRITAIN

...

Whilst touring the ship, Alistair Darling, Secretary of State for Trade and Industry said:

"Our energy supplies will increasingly come from a wide range of sources, meeting the twin challenges of energy security and climate change. It makes sense for consumers and business.

"This project together with others which have come on-stream this winter, like the pipelines from Norway and the Netherlands have dramatically increased the amount of energy we can import.

"It is also a tribute to the British gas market. Our liberalised markets and regulatory approach have given this company the confidence to do business here. This is good for our economy as well as our energy security."

The project, led by the US based company Excelerate, is the fastest ever time to market of any LNG facility in the world. The construction work began in the summer, meaning that laying all three pipelines, building

the loading arm and refurbishing the jetty has all happened in under a year (emphasis added)

- 40 The DTI Press release (P/2007/34) explained that the GasPort has enough power in one 20,000 tonne shipment to fuel 60,000 homes; it will convert liquid gas into gas usable by customers on board the EBRV vessel rather than onshore; this makes it quicker to deliver gas and reduces the impact on the environment; and the GasPort project forms an important part of the UK's measures to diversify and increase the security of gas supply.
- 41 The Secretary of State also said: "*Our liberalised markets and regulatory approach have given this company the confidence to do business here. This is good for our economy as well as our energy security.*"
- 42 Any decision that prevents the GasPort from operating as planned does not just affect the Claimants. It prejudices consumers who potentially suffer reduced supplies and/or higher prices; it restricts competition in the shipping and supply of gas by excluding the GasPort's imports from the NTS and it prevents the GasPort delivering the benefits to the UK's gas supply identified by the Secretary of State.

How the GasPort contributes to meeting the UK's energy needs

- 43 The purpose of the GasPort is not to provide constant flows of gas to UK consumers, although this is possible with the facility and the EBRVs, but to provide a solution to spikes in demand or unexpected reductions in supply. Indeed, in some years where other supplies are adequate, or the winter is mild, the GasPort may not be used at all. Nevertheless, to assist UK security of gas supplies, it is essential that the GasPort remains operational and able to accept substantial shipments of gas at any time. The GasPort is also designed to be used in the event that other facilities become unusable. For example, in February 2006 there was an explosion and fire at the Rough Gas Storage Facility, a partially depleted offshore gas field. Rough is the UK's largest gas storage facility and was closed for several months as a result of the incident. The closure led to substantial increases in wholesale gas prices as a result of market concerns about security of supply.
- 44 Since February 2007, the EBRVs have not made any further shipments to the GasPort, because UK gas prices have been low during this period whilst US prices have remained stronger. In the event of increased demands or reduced supplies in the UK, Exceletrate will

wish to use the GasPort to deliver gas to the UK market. For example, in recent years, the UK has not suffered a severe winter. If it does so, the market may well indicate that imports through the GasPort are commercially required, and Excelerate will be in a position to respond to such price signals. As explained above, the central purpose of the GasPort is to enable timely response to changes in supply or demand in the UK market.

45 Excelerate's concern, set out below, is that the expensive facility built at Teesside has effectively been sterilised and rendered useless by recent regulatory action by GEMA. The purpose of the GasPort is to respond rapidly to unexpected alterations in supply or demand patterns to ensure security of supply for UK consumers and reward Excelerate for the investment risk in its EBRVs and the GasPort. If the Claimants cannot obtain entry capacity at Teesside for the GasPort and the EBRVs to meet urgent and unforeseen gas needs, the GasPort will not be able to serve its purpose. This reduction in baselines is remarkable given that Ofgem was a strong supporter of the GasPort project [11/127-128, 15/223-226, 17/234-235 & 25/441-442]

46 At present there is only one other LNG import facility in the UK. This is a traditional LNG facility at the Isle of Grain in Kent. Other traditional onshore reception, storage and regasification facilities are under construction in Milford Haven, Pembrokeshire.

NGG NTS

47 National Grid Gas Plc ("NGG") is the operator of the NTS, under a licence granted under section 7 of the Gas Act. The NTS is Great Britain's high transmission gas system. It comprises around 7,000km of steel pipes and provides gas to power stations, large industrial users and local gas distribution networks. The NTS transports gas from a number of gas reception terminals and delivers it to the 8 regional gas distribution networks (in turn supplying 20 million industrial, commercial and domestic consumers) and also to around 50 large industrial consumers which are directly connected to the NTS (the majority of which are gas fired power stations).

Teesside baseline capacity and GEMA's Fourth TPCR

48 In 2005 GEMA started the TPCR to set terms and price controls for the gas and electricity transmission systems from 1 April 2007 for 5 years. As part of the review, GEMA

considered the baseline entry capacity system for the NTS, and the baseline entry capacity amounts at each NTS entry point, including Teesside. The details of the various GEMA consultations are contained in the documents in the exhibit bundle to Mr Bryngelson's witness statements [9/60-115, 12/129-163, 18/239-281, 45/636-651/ 46/652-667 & 52/767-787].

- 49 The baseline entry capacity amount at each point on the NTS is the amount of entry capacity which NGG, the NTS operator, is required to make available to NTS users. This baseline capacity is allocated to users (mainly gas suppliers) in quarterly, monthly, daily and interruptible daily blocks through various auctions. The baseline entry capacity amounts are specified in NGG's NTS Licence – at Table A2 of Schedule A. The NTS Licence (and therefore the baseline amounts of capacity specified in Table A2) may be modified by GEMA, with the agreement of NGG, as the licensee, under Section 23 of the Gas Act. But any such licence modification under Section 23 requires consultation.
- 50 GEMA held a series of TPCR consultations during 2005 and 2006, leading up to GEMA's final TPCR proposals, which were published in December 2006. Then GEMA was required by Section 23 to hold a statutory consultation before agreeing any licence modifications required to implement any of its TPCR proposals. This includes any alteration to the baseline entry capacity amounts specified for any particular entry point in Table 2 of Schedule A. In particular it includes any alteration to the baseline entry capacity amount at Teesside.
- 51 At the start of the TPCR, the baseline entry capacity which was specified in NGG's NTS Licence for the Teesside entry point was 761 GWh/day, which is equivalent to 70 million cubic metres (MCM) per day. As has been explained above, this was amply sufficient to accommodate the needs of the Teesside GasPort – and Excelerate had received assurances from NGG that this was the case [7/56-57].
- 52 Throughout the TPCR consultations, GEMA indicated that the Teesside entry point would continue to have a baseline capacity which was amply sufficient to accommodate the requirements of the GasPort.
- 53 For example, in GEMA's Initial Proposals of 26 June 2006 [18/239-281] the estimates of the baseline levels were provided in Appendix 11 to GEMA's initial proposals. GEMA proposed

a Teesside baseline of 63 MCM/d (millions of cubic metres / day), approximately 682 GWh/day (Table 11.6)² [18/260].

- 54 The Initial Proposals also stated that GEMA was considering proposing the introduction of a transfer mechanism between entry points:

11.13. ... In the light of consultation responses and further consideration of how best to tackle the identified defect, we have revised our proposals. We now propose to retain the concept of baseline capacity release obligations defined for each entry point (and offtake point) but introduce formal mechanisms to enable unsold baseline capacity to be reallocated. This will enable existing capacity (which to some extent can be substituted between different points on the network) to be allocated to where it is most in demand (emphasis added). [18/246].

- 55 GEMA indicated in general terms how the transfer mechanism would operate:

How NGG NTS complied with this obligation is for NGG NTS to determine in consultation with the industry and subject to approval by Ofgem. However, we anticipate that the generic regime could take the following form.

- **Before an auction shippers can indicate that they wish to bid for capacity at entry point A for transfer to entry point B.**
- **Shippers pay NGG NTS its modelling costs of working out an exchange rate from A to B.**
- **The auction is run for point A (possibly at the same time as auctions at other points) in which shippers wanting capacity at point A and shippers wanting capacity at point B can bid.**
- **The winner of the auction gets the capacity at point A and, if they had indicated a desire to do so and got an exchange rate, are obliged to transfer to (sic) capacity to point B and NGG NTS is obliged to transfer capacity (paragraph 1.22 of Appendix 11 to GEMA's initial proposals) [18/260-261].**

- 56 On 26 September 2006, GEMA published its Updated Proposals (dated 25 September 2006) on its website [45/636-650; 45/651]. Again, GEMA said it proposed to introduce a transfer mechanism:

² For ease of comparison, all figures expressed in millions of cubic metres per day have been converted to Gigawatt hours per day using a conversion ratio of 1:10.83.

10.8 Our proposals remain unchanged in this regard, although work on the quantification of the baseline numbers continues and some indicative numbers are provided in Appendix 9 for entry...”[45/643].

57 GEMA provided further details as to how the system of transfers would operate in practice (paragraphs 10.22 - 10.27 [45/646-647]). GEMA’s preference was for a system where gas shippers would obtain an “**exchange rate**” for transfer of capacity prior to an auction, and bid in the auction on that basis. There was no indication that GEMA was intending to implement any changes to the baseline capacity amounts separately from the proposed capacity transfer scheme.

58 On 19 October 2006, GEMA published an Addendum to its updated proposals, setting out its proposed baselines [49/703-704 & 46/652-667]. GEMA’s proposed baseline at Teesside remained unchanged from the June 2006 proposals – at 684 GWh/day, 63 MCM/d [44/611].

59 GEMA also stated that further work may be needed to test its proposals, including “**sensitivity testing of alternative modelling assumptions, for example new supply and demand scenarios which are likely to come to light over the next few months...**” (Appendix 9 to GEMA’s updated proposals paper, paragraph 1.14 [46/657]).

60 At this time Excelerate did not have any concerns in relation to Teesside’s baseline capacity, because GEMA had consistently indicated that the Teesside baseline capacity amounts would be amply sufficient for the requirements of the GasPort. Excelerate was also not aware of any other Teesside gas shippers having any such concerns.

61 On 15 November 2006, GEMA published a consultation paper proposing amendments to NGG’s licence to give effect to the above proposals. The terms included amendments implementing a capacity transfer system [50/705-767 at 716-725].

GEMA announces proposals to make a 50% cut in the Teesside baseline capacity amount

62 GEMA’s Final Proposals – which it described as its TPCR Decision Document - were published on 4 December 2006 [52/767-787].

63 In a substantial change of position, GEMA announced that it now proposed to more than halve the Teesside baseline – cutting it from 684 GWh per day (63 MCM/d) to 361 GWh per

day (33.36 MCM/d) [52/774]. At no stage had GEMA announced its intention to do this. At no stage did GEMA explain its reasons for this. GEMA gave industry parties – especially Excelerate – no chance to put in any proper consultation response on this proposal before announcing it.

64 GEMA's reasoning for this is extremely difficult to understand. It is framed in very general terms. GEMA's reasons do not refer at all to the position of Teesside or the new GasPort: see Appendix 8 [52/785-786],

1.7 Owing largely to the difference in interpretation of the modelling instructions between NGG NTS and Ofgem, the analysis provided by NGG NTS did not fully account for some of the zonal constraints on the network (ie. network constraints that are common to several entry points). We have therefore undertaken some additional analysis to take into account zonal constraints.

1.8 In order to do this we have taken the results of the nodal analysis discussed above and for each scenario calculated the maximum 'free increment' in each zone. We identified the maximum 'free increment' in each zone by taking the maximum nodal 'free increment' in that zone, as estimated by NGG NTS, as a proxy for the maximum zonal 'free increment'.

1.9 The maximum 'zonal' free increment was then divided between each node in the zone in such a way that each node received at least the amount of capacity which had already been sold by NGG NTS in respect of that zone. Any remaining 'zonal' free increment was then allocated in proportion to a measure of the 'size' of the entry point in question. The size of the entry point was proxied by the peak terminal supply associated with that entry point.

1.10 We then used an arithmetic average of the results from the three supply scenarios to calculate our proposed baselines.

1.11 In subsequent discussions with NGG NTS, issues were identified at a small number of entry points where this analysis still did not take adequate account of the zonal constraints on the network. We analysed these issues relative to the existing baselines, and made a small number of adjustments. In some instances these increased the proposed baselines while in other instances they led to a reduction in the proposed baselines...[52/786]

65 GEMA were still proposing that these reductions in baseline entry capacity would be implemented *at the same time* as a capacity transfer mechanism:

10.7 To give effect to this obligation in a transparent manner we are requiring NGG NTS to establish a methodology (which would need to be consulted on with interested parties, and approved by Ofgem) for calculating such transfer rates. We would expect NGG NTS to submit its proposed methodology to Ofgem by the end of February 2007, such that transfer rates can be issued from 1 April 2007 onwards. In November 2006 we consulted on draft legal text for this capacity transfer obligation. We will update the legal drafting for our second licence consultation in January 2007 in the light of Respondents' views (emphasis added) [52/775].

66 The purpose of the capacity transfer mechanism was also made clear:

10.8 The purpose of the new obligation is to guard against the risk that capacity is 'sterilised' at an entry point where it is not needed, and where by reducing the obligation at that entry point additional capacity can be made available elsewhere... (emphasis added) [52/775].

67 Finally, GEMA published proposals for the fees that NGG would be able to charge for the provision of incremental capacity (ie. capacity over and above the baseline [52/776]). The figures are expressed in terms of annual costs payable by gas shippers per year, over the 5-year period of the price control. For 0-25 GWh/day at Teesside, NGG would be entitled to an additional £0.0157 million per GWh, from 25-100 GWh, £0.0159 million, and from 100-500 GWh, £0.0241 million.

68 Accordingly, if Teesside shippers wished to add 300 GWh/day of lost capacity (roughly equivalent to the 'lost' baseline), it would cost them £6.41 million per annum rising to £6.95 million per annum by the end of the 5-year period³. These figures are an illustration of the costs to Teesside shippers of losing substantial NTS entry capacity.

Excelerate objects

69 On 19 December 2006, Excelerate emailed Ofgem and the DTI about these proposals, expressing its "major concern" about this troubling development which had, in the view of

³ $(0.0157 \times 25) + (0.0159 \times 75) + 0.0241 \times 200 = £6.41 \text{ million} + 8.5\% \text{ indexation after 5 years} = £6.95 \text{ million.}$

Rob Bryngelson (Executive Vice President and Chief Operating Officer of Excelerate Energy, LLC, the general partner and manager of Excelerate), a “major adverse impact for the Teesside GasPort Project” [55/798-799]. Excelerate also expressed its concern that St Fergus appeared to be being treated more favourably than Teesside. Excelerate received a reply from the DTI on 21 December 2006:

I understand from OFGEM that the entry capacity baselines have been discussed over a period of time with the Transmission Price Controls and might be difficult to amend at this stage in the proceedings. One possible way round this problem is that OFGEM are putting an obligation on NGG to facilitate the transfer of unsold capacity to meet demands for capacity elsewhere. We will continue to monitor the situation [55/797].

- 70 Excelerate was reassured that the DTI were monitoring the situation and believed that a solution would be found that would avoid sterilising the GasPort, which at the time was nearing completion.

Second licence consultation

- 71 On 26 January 2007, GEMA published a second consultation paper proposing detailed changes to NGG’s licence necessary to give effect to the Final Proposals. Again, the draft amendments included terms giving effect to a capacity transfer system [62/837-864].

Notice of proposed modification

- 72 On 16 February 2007, GEMA published a formal statutory notice under section 23(3) of the Gas Act indicating that it proposed to modify NGG’s licence to introduce the reduced baseline capacities.
- 73 But no provision was made to amend NGG’s licence to introduce the transfer obligation for reallocating capacity between entry points, even though this was an integral part of the TPCR package. Again no sensible reasons were given for this:

3. **The Authority has consulted informally on two occasions setting out draft licence modifications it considers necessary to give full effect to the proposed revised transmission price controls. During this consultation process, the Authority has received several comments and responses from NGG and other interested parties which have identified the need for further refinement of**

the proposed licence modifications before they can be formally implemented.

In the light of these comments, the Authority proposes to implement the transmission price control review final proposals in two stages:

- (a) the first stage involves bringing forward a proposed licence modification which is deemed necessary to roll forward the current regulatory and commercial regime beyond 31 March 2006; and**
- (b) the second stage involves a further statutory consultation on further proposed licence modifications which are considered necessary to give full effect to the transmission price control review final proposals which the Authority proposed will be applied with retrospective effect from 06:00 hours on 1 April 2007.**

...

- 5. This Notice represents the first stage in the process outline (sic) above [67/877].**

74 NGG consented to the proposed modification [69/886]. Excelerate and others strongly objected [70-76/887-899]:

- (a) In correspondence with GEMA, Excelerate pointed out the GasPort project had received support from Ofgem and there was never any indication that the baseline capacity was going to be reduced by such a large amount (53%) [71/889-890]. The effect of the reduction in baseline capacity would be to reduce the baseline capacity *below* current peak flows of gas. The baselines were insufficient to meet current flows of gas, let alone potential future flows now that the GasPort had become operational. Further, it was fundamentally flawed to use previous purchases of long-term capacity as the key basis for determining a baseline. Given the decline in UK offshore gas supplies, Excelerate and other parties bought their capacity daily in the short-term market at lower prices because capacity was not scarce and had no secondary market value (as NGG have to offer within-day zero priced capacity in clearing auctions). It would be wrong to penalise the Claimants for making rational purchasing decisions in the market.

- (b) E.on UK expressed concerns about the sudden and unexpected reduction in the baselines but:

recognising that the new baselines are likely to be implemented by Ofgem, we consider it imperative that Ofgem ensures National Grid NTS meets its licence obligation by delivering an entry capacity transfer mechanism as soon as possible... We believe it is imperative for the continued efficient and economic operation of the market that a sold, then unsold, capacity transfer mechanism (conducted in that order) is operational as soon as the 2007 AMSEC auction has concluded. If a transfer mechanism is not implemented before this date, the release of entry capacity will not be optimised, which may ultimately prevent gas supplies being delivered to the UK [70/888].

- (c) RWE expressed concerns about the lack of transparency in the process which “reduces confidence in the baselines and increases the perception of regulatory risk, which may serve to undermine shipper’s willingness to make long-term capacity commitments or undertake investments” [72/891].
- (d) BP expressed concern about the low proposed baseline at Teesside and concluded that “the justification for the revised baselines has still not been given” [73/893]. BP also noted that “The notice issued by Ofgem outlining the proposed licence modification separates the revised baselines from capacity transfer and other related issues, which BP believes is inappropriate as we understand they are integral to the settlement”[73/894].

GEMA’s Decision to reduce the Baseline Entry capacity at Teesside

- 75 Despite all the above representations, on 30 March 2007, GEMA made the proposed modifications on entry capacity baselines, including reducing the Teesside baseline capacity from 761 GWh/day to 361 GWh/day [78/902-905].

The effect on the GasPort

- 76 Prior to the decision, the baseline capacity at Teesside was 761 GWh/day. Historically, only a proportion of this baseline capacity had been used. The peak gas flows in 2002/3 for Teesside were around 433 GWh/day. Since then, peak flows steadily reduced. In 2006/7 peak gas flow

was around 379 GWh/day. There was ample capacity at Teesside for the GasPort. Indeed, that was the reason the GasPort was sited at Teesside.

- 77 The Decision more than halved the baseline capacity for Teesside - from 761 GWh/day to 361 GWh/day. The effect of the Decision is that the Claimants do not have access to sufficient entry capacity at Teesside to enable the GasPort to operate as planned. The GasPort, and the gas which could be introduced to the UK energy markets through the GasPort, are effectively stranded off-shore.
- 78 The reduction in the Teesside baseline capacity means that the new Teesside baseline capacity limit will be insufficient to cover existing usage, let alone the increased flows that will occur now that the GasPort has been constructed.
- 79 The Claimants cannot seek to secure the necessary capacity for the GasPort's operation by bidding for entry capacity at other NTS entry points, and transferring that capacity to Teesside, because of GEMA's continuing failure to introduce the transfer obligation, as explained below.
- 80 This does not only prejudice the Claimants. It also prevents the GasPort delivering the benefits to the UK's gas supply identified by the Secretary of State.
- 81 This situation is wholly unjust. It is also contrary to GEMA's legal duties and responsibilities (set out below) and to the principles of proper regulation.

Freedom of Information Act request

- 82 Excelerate made a Freedom of Information request to GEMA on 29 March 2007 with a view to obtaining information which might provide it with more understanding of the actual reasoning behind GEMA's decision to reduce Teesside's baseline capacity (in particular, the alleged physical constraints in the NTS which led NGG to suggest a very low baseline for Teesside) [77/900-901]. No response was received to this request until 30 April 2007 [83/958-1007]. Excelerate is still waiting for Ofgem to provide some of the information it requested.

Third licence consultation

83 On 25 April 2007, GEMA published a further set of proposed licence amendments, including terms relating to baseline capacity transfer [82/958-1007]. Comments were requested by 24 May, with GEMA expecting to commence the statutory consultation process under section 23 of the Gas Act in June and modify the NGG NTS licence in July 2007. Under these amendments, NGG will be required to publish a statement detailing its methodology for capacity transfer between entry points. Excelerate responded to this consultation, suggesting that zonal aggregate baselines were appropriate, with free transfer between individual entry points within zones, as were financial incentives on NGG to make more capacity available [85/1011-1013]. GEMA gave notice of the Section 23 consultation on the licence modifications on 25 June 2007 [108/1631-1632].

GEMA delays the February 2007 Auctions

84 On 17 January 2007, GEMA directed that the Annual Monthly System Entry Capacity (“AMSEC”) auction due to be held in February 2007 be postponed until after changes had been made to the baselines [61/834-836]. The reason given for this change was to ensure that NGG did not have to offer baseline capacity that GEMA was minded to reduce (Urgent Modification Proposal 129). This prevented Excelerate buying capacity at Teesside on the basis of the actual amounts which were specified in the NTS licence at February 2007.

NGG’s undertaking to amend the interruptibility regime to enable the GasPort to operate

85 The delayed AMSEC auctions took place on 11 May 2007. Prior to the auction, consideration was given to introducing a capacity transfer provision by an urgent Modification Proposal to the Uniform Network Code (“UNC”).

86 On 4 May 2007, NGG wrote to Robert Hull, Ofgem’s Director of Transmission, in relation to the current position regarding capacity transfer and capacity trades [83A/1007A-1007B]. The letter outlines two options – (a) to introduce the transfer obligation for the May 2007 AMSEC auctions and (b) not to introduce it until next year’s AMSEC auction.

87 NGG’s letter also contains the following undertaking: “**Should this alternative option be taken [i.e. not to introduce the transfer obligation for the May 2007 auction] we would, as**

discussed, undertake to develop a UNC modification to introduce revisions to the interruptible regime which we believe are likely to satisfy the requirements of the shipper at Teesside this winter.” It is understood that this refers to the GasPort.

UNC Modification Proposal 138 and the delayed AMSEC auction

88 On 8 May 2007, GEMA rejected the urgent proposal made by NGG to introduce a limited capacity trading scheme for an annual sale of sold capacity. GEMA held that the proposal “only implements a small subset of the capacity trade mechanism and does not introduce the associated mechanism for the transfer of unsold capacity. Without this mechanism it is unclear that introducing capacity trading [on its own] will lead to a more efficient and economic operation of the NTS”. Further, GEMA “is proposing to introduce obligations on NGG NTS to facilitate capacity trade and produce a capacity trade methodology through a modification to NGG NTS’s gas transporters licence, such an obligation is to be introduced with retroactive effect from 1st April 2007”. However, no such obligation has yet been introduced (Modification Proposal 138 [84/1008-1010]).

No modification proposal has been introduced to revise the interruptibility regime to satisfy the GasPort’s requirements

89 Despite the undertaking in NGG’s letter of 4 May 2007, NGG and Ofgem have not developed or introduced a modification to the UNC to introduce revisions to the interruptible regime to satisfy the requirements of the Teesside GasPort for this winter. The Claimants do not know for certain whether or when this will happen, or whether any such revisions can in fact satisfy the requirements of the GasPort.

GEMA rejects further proposals to modify the UNC to introduce the transfer obligation

90 In urgent Modification Proposals 150, 150A, 151 and 151A NGG and E.ON both made further proposals for the transfer of unsold capacity and the implementation of capacity trading. NGG propose the introduction of a further auction of unsold capacity (Modification Proposal 150) [89/1020-1025]. E.ON proposed a further round of the AMSEC auction, with exchange rates fixed at 1:1 within zones (Modification Proposal 150A) [89/1025-1028]. As for sold capacity, NGG proposes a system of limited transfer windows, plus exchange rates set by NGG (Modification Proposal 151) [90/1037-1043] E.ON proposed a more flexible

system of 1:1 transfers within zones, with the potential for an exchange rate for inter-zonal transfers (Modification Proposal 151A) [90/1043-1051]. On 12 June 2007, GEMA rejected all these proposals [91/1060-1064].

- 91 These modifications were proposed because of industry concerns that the lack of a capacity transfer system was unacceptable, in the context of the reduced baselines at Teesside and elsewhere.

Auctions

- 92 Prior to the reduction in the baseline capacity on 1 April 2007, a Long-Term System Entry Capacity ("LTSEC") auction took place in September 2006, for capacity in 2008-2023 inclusive. There was good availability of Teesside baseline capacity in that auction. The auction closed early on 26 September 2006 following a significant period with no changes to bids. Significant long-term Teesside capacity remained unsold at the end of the auction.
- 93 Excelerate considered buying Teesside capacity in the September 2006 LTSEC auction, but concluded that given (a) Teesside's high capacity baseline, (b) declining gas flows at St Fergus; and (c) the absence of a secondary market in capacity and (d) NGG's obligation to have a zero priced within-day clearing auction, it was not necessary and/or uneconomic to make long term commitments in Teesside entry capacity.
- 94 In making this decision, Excelerate received differing advice from its various UK professional advisers. Excelerate's UK gas strategic advisers recommended that Excelerate purchase long-term capacity because they forecast that capacity prices were going to rise although Excelerate's shipper, RWE, strongly recommended that it did not need to purchase such capacity because there was ample capacity available at Teesside, there was no secondary market, and so purchasing long-term capacity was entirely unnecessary [32-44/517-635]. Neither of Excelerate's advisers expressed any concern that baselines might be reduced substantially as a result of the TPCR. GEMA did not announce that it was planning to take into account the quantities sold in the September auctions in its decisions on baseline capacity levels until it was too late for industry parties, including Excelerate, to consider this and bid in the September auctions to protect the Teesside baseline capacity levels. Had it

received such advice, Excelerate's approach to these auctions would no doubt have been very different.

- 95 Since the reduction in the baseline capacity on 1 April 2007, the following further auctions have taken place.
- 96 The delayed AMSEC auction, discussed above, took place in May 2007. In this annual action, monthly entry capacity for June 2007 to March 2009 was sold. The delayed auction was based on the TPCR's reduced baselines, with no transfer obligation in place [80/923-929]. All Teesside capacity for the months November 2007 - February 2008 which was available in the AMSEC auction was sold (see table below). Excelerate was able to buy some capacity (approximately 2 MCM/day or 20 GWh/day) for the months December 2007 - February 2008) (See table below). To offload an EBRV cargo at these rates would take around 40 days - nearly 6 times as long as planned. Although some further interruptible capacity may be available, this is only likely to amount to around 3 MCM/day (if Teesside's average gas flows are 30 MCM/day) because NGG is limited in relation to volume of interruptible capacity it can sell under its network code, meaning that a cargo would take around 15 days to offload. For obvious reasons, it is uneconomic to have an expensive EBRV tied up in port for this length of time, when the ship is capable of regasifying its entire cargo in only 7 days.

Table: Unsold capacity at Teesside

Month	Teesside		
	TE		
	Release Obligation	Aggregate Obligated Quantity Sold	Quantity Unsold
	kWh/d	kWh/d	kWh/d
Jun-07	361,300,000	282,498,060	78,801,940
Jul-07	361,300,000	316,423,896	44,876,104
Aug-07	361,300,000	319,463,641	41,836,359
Sep-07	361,300,000	306,476,094	54,823,906
Oct-07	361,300,000	353,149,632	8,150,368
Nov-07	361,300,000	361,299,997	3
Dec-07	361,300,000	361,299,997	3
Jan-08	361,300,000	361,299,996	4
Feb-08	361,300,000	361,300,000	0
Mar-08	361,300,000	341,110,296	20,189,704
Apr-08	361,300,000	312,317,256	48,982,744
May-08	361,300,000	302,939,464	58,360,536
Jun-08	361,300,000	292,935,267	68,364,733
Jul-08	361,300,000	317,270,820	44,029,180
Aug-08	361,300,000	319,879,190	45,420,820
Sep-08	361,300,000	312,930,836	48,369,164
Oct-08	361,300,000	327,730,568	33,569,432
Nov-08	361,300,000	327,730,570	33,569,430
Dec-08	361,300,000	289,040,000	72,260,000
Jan-09	361,300,000	289,039,999	72,260,001
Feb-09	361,300,000	289,040,000	72,260,000
Mar-09	361,300,000	289,040,000	72,260,000
Apr-09	361,300,000	162,354,911	198,945,089
May-09	361,300,000	162,354,911	198,945,089
Jun-09	361,300,000	162,354,911	198,945,089
Jul-09	361,300,000	138,253,968	223,046,032
Aug-09	361,300,000	138,253,968	223,046,032
Sep-09	361,300,000	138,253,968	223,046,032

Table: Teesside capacity purchased by Exceletrate in the AMSEC auction

Exceletrate Capacity at Teesside

Date	Bid (kWh/d)	Allocation (kWh/d)	Allocation (kWh/d)	Price (p/kWh)	Total Cost
Dec 2007	15,000,000	15,000,000	1.38	0.0029	13,485
Dec 2007	15,000,000	2,925,421	0.27	0.0028	2,539
Dec 2007	15,000,000	-	0.00	0.0027	-
Total	45,000,000	17,925,421	1.65		16,024
Jan 2008	15,000,000	15,000,000	1.38	0.0029	13,485
Jan 2008	15,000,000	9,333,529	0.86	0.0028	8,102
Jan 2008	15,000,000	-	0.00	0.0027	-
Total	45,000,000	24,333,529	2.24		21,587
Feb 2008	15,000,000	15,000,000	1.39	0.0029	12,615
Feb 2008	15,000,000	7,944,846	0.73	0.0028	6,451
Feb 2008	15,000,000	-	0.00	0.0027	-
Total	45,000,000	22,944,846	2.11		19,066

Reserve price was 0.0020 p/kwh
 Exceletrate ship capacity at present is 11 MCMD
 Total of 33 MCMD is sold for Nov 07, Dec 07, Jan 08, Feb 08

97 The AMSEC auction also revealed a significant amount of unsold capacity at St. Fergus (over 200 GWh/day), even though sales were 15-20% above flow forecasts, presumably to buyers worried about capacity transfers away from St Fergus, or who hoped to sell such capacity in a new secondary market to transferees in other entry points. The amount of unsold St. Fergus capacity (and sold capacity which is unlikely to be used) is roughly equivalent to the amount of capacity by which the TPCR would reduce Teesside's entry

capacity and would, if it had been available in the Teesside auction, have been sufficient to meet Excelerate's needs.

Table: Unsold capacity at St. Fergus

Month	St Fergus		
	Release	Aggregate	Quantity
	Obligation	Obligated	Unsold
	kWh/d	Quantity Sold	kWh/d
Jun-07	1,670,700,000	1,268,488,223	402,231,777
Jul-07	1,670,700,000	1,188,113,483	482,586,517
Aug-07	1,670,700,000	1,203,113,483	467,586,517
Sep-07	1,670,700,000	1,205,610,323	465,089,677
Oct-07	1,670,700,000	1,434,802,108	235,897,892
Nov-07	1,670,700,000	1,487,830,651	182,869,349
Dec-07	1,670,700,000	1,488,794,274	181,905,726
Jan-08	1,670,700,000	1,444,627,207	226,072,793
Feb-08	1,670,700,000	1,442,069,787	228,630,213
Mar-08	1,670,700,000	1,419,616,410	261,083,690
Apr-08	1,670,700,000	1,418,224,203	252,475,797
May-08	1,670,700,000	1,417,024,203	253,875,797
Jun-08	1,670,700,000	1,396,124,203	274,575,797
Jul-08	1,670,700,000	1,299,397,131	371,302,869
Aug-08	1,670,700,000	1,306,597,131	364,102,869
Sep-08	1,670,700,000	1,316,297,131	354,402,869
Oct-08	1,670,700,000	1,437,246,624	233,453,376
Nov-08	1,670,700,000	1,435,862,157	234,837,843
Dec-08	1,670,700,000	1,336,569,980	334,140,020
Jan-09	1,670,700,000	1,336,560,000	334,140,000
Feb-09	1,670,700,000	1,336,560,000	334,140,000
Mar-09	1,670,700,000	1,336,376,615	334,323,385
Apr-09	1,670,700,000	676,656,901	994,043,099
May-09	1,670,700,000	676,656,901	994,043,099
Jun-09	1,670,700,000	676,656,901	994,043,099
Jul-09	1,670,700,000	570,656,121	1,100,043,879
Aug-09	1,670,700,000	570,656,121	1,100,043,879
Sep-09	1,670,700,000	570,656,121	1,100,043,879

98 Rolling Monthly System Entry Capacity auctions (“RMSEC”) took place in April and May 2007 [81/930-932]. In these auctions, remaining capacity for the month ahead is offered for sale. The June 2007 auction (of capacity for July 2007) is scheduled for the last week in June 2007 [88/1017-1019]. Excelerate understands that there may well be unsold capacity in this month’s auction due to reduction in flows from the UKCS fields in the summer. Excelerate does not intend to purchase any of this capacity as Teesside flows are low and Excelerate has no plans to bring gas to the UK in July 2007.

99 Daily auctions continue to take place based on the TPCR’s reduced baselines of unsold capacity. As all capacity at Teesside for November 2007 - February 2008 has been sold, at present there will be no baseline capacity available for purchase on a daily basis during these months, except for the small amount of interruptible capacity.

Excelerate’s Letter of Claim

100 On 13 June 2007, Excelerate’s solicitors, Watson Farley and Williams LLP, sent a pre-action letter of claim for judicial review to GEMA. The letter is a detailed (12 page) statement of Excelerate’s complaints (1) with the decision to reduce the baseline capacity amount at

Teesside, (2) with the continuing failure to implement the transfer obligation, and (3) with GEMA's decision not to implement E.ON's Modification Proposals 150A and 151A to the Uniform Network Code. The letter asked for a reply within 7 days. The Court is respectfully asked to read this letter [92/1065-1077].

Events since Excelerate's letter of claim

- 101** On 19 June 2007, a reply to this pre-action letter of claim was received from GEMA's solicitors, Herbert Smith LLP. This letter does not answer any of the substantive issues raised in Excelerate's letter of claim, but reserves GEMA's position on timing and procedural issues [94/1079].
- 102** On the same day, 19 June 2007, GEMA sent an Open Letter to the industry. The Court is respectfully asked to read this letter [95/1080-1087]. GEMA says that it is "*very conscious of the ongoing concerns that a number of shippers have about the ongoing development of the entry capacity arrangements.*" GEMA acknowledges that in the December 2006 TPCR Final Proposals, it had expected the transfer obligation to be in place by 1 April 2007. GEMA says that it is "*disappointed that this has not happened yet*". GEMA expects NGG to progress with implementing new mechanisms before the winter, by proposing further modifications to the UNC to introduce a transfer obligation. GEMA notes that the timeline if the new arrangements are to be in place before the winter is "*increasingly challenging*". GEMA suggests that NGG and "*other stakeholders*" develop a number of potential different proposals for consultation. GEMA also says it is directing NGG to make public certain capacity and constraints information which the industry had been asking for. Excelerate has in fact been requesting this for several months [77/900-901].
- 103** In the letter, GEMA announced that it would ensure that a fair capacity transfer mechanism would be in place for this winter. GEMA acknowledged that there had been substantial delay in introducing a capacity transfer mechanism, a point Excelerate had made in its letter of claim. However, no proposals were made as to the content of the mechanism, or how it will operate in practice. GEMA suggested that the industry should put forward multiple urgent modification proposals in the hope that the best option will emerge through rapid consultation. As a result of GEMA's decision on the sets of modifications, and despite its announcement of 19 June 2007, there is still no capacity transfer system in place for this

winter. Nor is any significant baseline capacity available at Teesside at present. It is therefore entirely uncertain whether the problems at Teesside will be fully or partially remedied by the introduction of a transfer obligation.

- 104** This letter does not provide Excelerate with a secure and practical solution to the problems facing the GasPort from the reduction of baseline capacity at Teesside. The details of the UNC modifications which GEMA wants NGG and other stakeholders to propose are not yet known. They are still to be developed. The letter says that a range of possible proposals should be put forward. Excelerate have no details of what these will contain. This letter gives Excelerate no security that the GasPort's problems, which have been caused by GEMA's own decisions, will in fact be solved by whatever finally emerges.
- 105** Excelerate also do not understand why GEMA says that it is "*disappointed*" that the transfer obligation is not yet in place. GEMA said in its December TPCR document that the transfer obligation should be in place from 1 April 2007 - at the same time as the baseline capacity decision, including the baseline reduction at Teesside. But GEMA did not take steps to ensure this happened. GEMA then split off the baseline capacity changes from the transfer obligation – GEMA agreed with NGG to amend NGG's licence so that the Teesside baseline capacity reduction took effect on 1 April 2007 - without any transfer obligation. GEMA postponed the February 2007 AMSEC auctions until May 2007 – so that NGG was only required to sell capacity calculated on the reduced baseline at Teesside – and again without the transfer obligation. GEMA then used its own powers to direct that UNC modification proposals which would have introduced the transfer obligation should not be implemented. Most recently GEMA did this on 12 June 2007, when it rejected the modification proposals raised both by E.ON and NGG. The delay in introducing the transfer obligation, and all the problems which it has caused and is still causing, are regrettably very largely GEMA's own doing.
- 106** GEMA reduced the baseline capacity reduction at Teesside before it implemented the rest of its TPCR package. On 25 June 2007, Ofgem published the consultation notice under Section 23 of the Gas Act in respect of the other proposals in the TPCR package [108/1631-1632]. These include proposed licence modifications relating to entry capacity transfer, trading and substitution [109/1633-1759]. The proposed licence changes, however, do not contain the detail which is needed to understand how entry capacity transfer, trading and substitution will

actually work in practice. Whilst NGG has carried out a consultation in relation to its methodologies for transfer and trade and substitution, these were completed prior to final agreement on the new Licence and it is not clear if there needs to be further consultation. In any event, there is no indication as to whether NGG is making any of the modifications to these methodologies suggested by Excelerate and other shippers. Given this uncertainty, this notice provides no security for the operation of the GasPort.

107 On 27 June 2007 Ofgem published a further Open Letter to the industry on NTS Entry Capacity [95A/1187A-1187C]. This focuses on Ofgem's ideas for capacity substitution between entry points where users have given signals in the long term LTSEC auctions that incremental (i.e. additional) capacity is needed at a particular point. Ofgem say that capacity transfer, capacity trade and capacity substitution will be "*increasingly important*" because of the changes to the sources of gas supply to the UK market, with North Sea gas declining and "*increased dependence on gas imports from a diverse range of sources*". Therefore, the NTS and the commercial arrangements for securing NTS entry capacity "*need to become more flexible*". Ofgem say they "*are firmly committed to the implementation of the agreed TPCR package, which includes the introduction of the substitution mechanisms, together with capacity trade and transfer, as they form an integral part of the overall TPCR risk and reward package.*" They "*firmly believe that it is still possible for these mechanisms to be introduced before this winter and we fully expect NGG to do so.*" They explain that: "*The development of a capacity trade and transfer regime will only address entry capacity issues in the short term (probably up to two years ahead), e.g. for this year (including this winter 2007/8) and next 2008/9... (C)apacity substitution mechanisms will be required to deal with entry capacity issues further ahead (probably more than two years ahead).*" The relevant methodology for this is still to be developed by NGG.

108 The letter does not provide any security that the GasPort will in practice be able to obtain the access it needs to the NTS through the Teesside entry point. The next long term auctions are to take place in September 2007. While there appear to be discussions taking place concerning a transfer and trade modification for the 2007/2008 winter these are not yet in place or fully finalised. Moreover, there are significant uncertainties for the longer term in relation to capacity transfer and trade arrangements. Additionally, the introduction of new substitution arrangements could further reduce available capacity in the Northern Zone. How

these new proposals will work in practice is not known. There is no certainty about the timing of their introduction. NGG's letter of 4 May 2007 is much more pessimistic on the timetable. Ofgem's statement that capacity substitution (rather than transfer) is necessary to address longer term issues is an additional concern, because it suggests that introducing the transfer obligation may not in practice be enough to protect the GasPort's position. It points to the need for GEMA to reconsider the baseline capacity reduction at Teesside. If Teesside had enough capacity for the GasPort to operate as planned, there would be no need to seek to remedy the problem by these transfer and substitution proposals, which remain largely unknown.

- 109 Ofgem's reference to changes to the UK's sources of gas supplies, and the need for flexible arrangements for NTS entry capacity, are not consistent with preventing the GasPort from responding to the UK's needs.
- 110 Ofgem accepts that the TPCR proposals are an "*agreed package*" and says that the transfer mechanism is an "*integral part*" of this agreed TPCR package. But GEMA itself split up the TPCR package, introducing the severe reduction in Teesside's baseline capacity separately from the transfer obligation. GEMA delayed the February 2007 auction (in which Teesside would have had a baseline of 761 GWh/d, as set out in the NTS licence at that date) and then GEMA required the delayed auction to go ahead in May 2007 on the reduced Teesside baseline of 361 GWh/d, without any transfer obligation.

C. Legal Framework and Grounds

Procedure for amending the Licence and the UNC

- 111 The Licence, which authorises NGG to operate the NTS, is treated as granted to NGG under Section 7 of the Gas Act.
- 112 The provisions defining the NTS entry arrangements are found either in the Licence or in documents issued under the Licence, such as the UNC. The NTS entry capacity baselines are specified in Table A2 of Schedule A to the NTS Licence.

113 The NTS Licence may be modified by GEMA with the agreement of NGG (as licensee) under section 23 of the Gas Act [96/1099-1101], subject to the procedural requirements contained in section 23.

114 The UNC is issued under Condition A11 of the Licence [100/1142-1152]. The UNC may be modified under the procedures provided in Condition A11. These include a requirement of consultation. Condition A11 also contains a procedure for urgent modifications to the UNC. The final decision on modifications to the UNC under Condition A11 is taken by GEMA. Condition A11 also sets out “relevant objectives” which govern decisions on UNC modification proposals.

GEMA’s legal duties and responsibilities

Section 23 - consultation

115 Before making any modification under section 23 of the Act, GEMA is required by sections 23(3) and (4) to give a notice which (i) states that GEMA proposes to make the modifications, (ii) sets out their effect, and (iii) states GEMA’s reasons why it proposes to make the modifications. GEMA must then consult on the proposed modifications.

Section 38A - reasons

116 Section 38A of the Act requires GEMA to give reasons, inter alia when taking decisions on modification proposals to the UNC.

Section 4AA – statutory objectives and duties

117 GEMA’s statutory objectives and duties under Section 4AA of the Act [96/1088-9] are (in summary):

- (a) to further the “principal objective” of protecting the interests of consumers, wherever appropriate by promoting competition between persons engaged in or in commercial activities connected with the shipping, transportation or supply of gas: section 4AA(1);

- (b) to have regard to the need to secure that, so far as is economical, all reasonable demands in Great Britain for gas are met: section 4AA(2)(a);
- (c) to promote efficiency and economy on the part of persons licensed under the Act: section 4AA(5)(a) – this includes both gas transporters and gas shippers;
- (d) to secure a diverse and viable long term energy supply: section 4AA(5)(c);
- (e) to have regard to the effect on the environment: section 4AA(5);
- (f) to have regard to the principles under which regulatory action should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed: section 4AA(5A)(a);
- (g) to have regard to any other principles appearing to it to represent best regulatory practice: section 4AA(5A)(b).

Section 9 – NGG’s duties

118 GEMA is also responsible for enforcing the duties imposed on NGG under section 9 of the Act [96/1097-1098], which include (in summary):

- (a) to develop and maintain an efficient NTS: section 9(1)(a);
- (b) to comply, so far as is economical, with any reasonable request for connection to the NTS and to convey gas by the NTS: section 9(1)(c);
- (c) to facilitate competition in the supply of gas: section 9(1A);
- (d) to avoid any undue preference or undue discrimination: section 9(2).

119 GEMA is also responsible for enforcing NGG’s duties under the Licence Conditions, including (for example) the duty of non-discrimination under Condition A6.

Section 5AA Utilities Act 2000 – Impact Assessment

120 Under section 5A of the Utilities Act 2000 [97/1105-6], GEMA was required in the present case to carry out an impact assessment in accordance with the requirements of that section, including environmental effects, and to consult on the impact assessment.

Condition A11 of the Licence

121 GEMA can direct a modification to the UNC, under Paragraph 15(b) of Condition A11, where the modification “in the opinion of the Authority, will, as compared to the existing provisions of the uniform network code or any alternative proposal, better facilitate, consistent with the licensee’s duties under section 9 of the Act, the achievement of the relevant objectives”.

122 The “relevant objectives” are listed in hierarchical order in Paragraph 1(a) to (f) of Condition A11. They are:

- (a) the efficient and economic operation of the NTS itself;
- (b) the co-ordinated, efficient and economical operation of the combined pipeline system and/or the pipe line systems of one or more other gas transporters;
- (c) the efficient discharge of NGG’s obligations under NGG’s licence;
- (d) the securing of effective competition between relevant shippers, between relevant suppliers and/or between DN operators and relevant shippers.
- (e) The provision of reasonable economic incentives for relevant suppliers to secure domestic customer supply security standards;
- (f) The promotion of efficiency in the implementation and administration of the UNC.

Community law obligations

- 123 GEMA must also comply with all relevant Community obligations. These include the provisions of EC Directive 2003/55/EC on common rules for the internal market in natural gas ('the Directive') [98/1107-1128] and of Regulation (EC) No 1775/2005 on conditions for access to the natural gas transmission networks ('the Regulation') [99/1029-1141].

The Directive

- 124 The Directive's objective is to promote a competitive internal market in gas. The Claimants rely in particular on Recitals (6) and (7), and Articles 3.1, 8.1, 18.1 25.1, 25.2 and 25.4:

(6) **The main obstacles in arriving at a fully operational and competitive internal market relate to, amongst other things, issues of access to the network, access to storage, tariffication issues, interoperability between systems and different degrees of market opening between Member States.**

(7) **For competition to function, network access must be non-discriminatory, transparent and fairly priced. [98/1107]**

Article 3(1). Member States shall ensure ... that ... natural gas undertakings are operated in accordance with the principles of this Directive with a view to achieving a competitive, secure and environmentally sustainable market in natural gas, and shall not discriminate between these undertakings as regards either rights or obligations (emphasis added) [98/1112].

Article 8(1). Each transmission, storage and/or LNG system operator shall:

(a) **operate, maintain and develop under economic conditions secure, reliable and efficient transmission, storage and/or LNG facilities, with due regard to the environment;**

(b) **refrain from discriminating between system users or classes of system users, particularly in favour of its related undertakings [98/1113].**

Article 18(1) requires that third party access must be granted to gas transmission networks on a non-discriminatory basis [98/1117].

Article 25 (regulatory authorities), GEMA is "responsible for ensuring non-discrimination, effective competition and the efficient functioning of the market". This includes authority to require transmission

system operators to ensure access conditions are proportionate and non-discriminatory [98/1120-1121]).

The Regulation

- 125 Regulation 1775/2005/EC “**aims at setting non-discriminatory rules for access conditions to natural gas transmission systems**” (Article 1) [99/1129-1141].
- 126 The Claimants rely on the provisions of the Regulation, including:
- (a) **Article 1** (non-discriminatory access, harmonised principles),
 - (b) **Article 4** (transmission system operators “shall ensure they offer services on a non-discriminatory basis to all network users”),
 - (c) **Article 5** (maximum capacity at all relevant points shall be made available; capacity allocation mechanisms to be non-discriminatory, transparent, provide signals for efficient and maximum use of technical capacity; be flexible; and be capable of adapting to evolving market circumstances),
 - (d) **Article 6** (transparency requirements – publish information necessary for network users to gain effective network access),
 - (e) **Article 8** (trading of capacity rights),
 - (f) **Article 9** (Guidelines),
 - (g) **Article 10** (regulatory authorities – GEMA), and
 - (h) **The Annex to the Regulation (Guidelines)**, especially at:
 - (i) **Guidelines 1(1), 1(2), 1(3)**,
 - (ii) **Guidelines 2.1 and 2.2**;
 - (iii) **Guideline 3**, including the requirement of timely provision of information as to changes in Guideline 3.1(j) and the requirement of advance notice of available capacities at least 18 months ahead in Guideline 3.3(2).

127 The recitals record the aims of the Regulation in greater detail:

- (11) **The management of contractual congestion of networks is an important issue in completing the internal gas market. It is necessary to develop common rules which balance the need to free up unused capacity in accordance with the 'use-it-or-lose-it' principle with the rights of the holders of the capacity to use it when necessary, while at the same time enhancing liquidity of capacity...**
- (13) **For network users to gain effective access to gas networks they need information in particular on technical requirements and available capacity to enable them to exploit business opportunities occurring within the framework of the internal market. Common minimum standards on such transparency requirements are necessary. The publication of such information may be done by different means, including electronic means [99/1130].**

128 Article 4 of the Regulation requires national transmission operators to ensure they offer their services on a non-discriminatory basis to all network users [99/1132-1133].

129 Article 5 of the Regulation sets out the principles applying to capacity allocation mechanisms:

- 1. **The maximum capacity at all relevant points referred to in Article 6(3) shall be made available to market participants taking into account system integrity and efficient network operation.**
- 2. **Transmission system operators shall implement and publish non-discriminatory and transparent capacity allocation mechanisms, which shall:**
 - (a) **provide appropriate economic signals for efficient and maximum use of technical capacity and facilitate investment in new infrastructure;**
 - (b) **be compatible with market mechanisms including spot markets and trading hubs, while being flexible and capable of adapting to evolving market circumstances.**
- 5. **In the event that physical congestion exists, non-discriminatory, transparent capacity allocation mechanisms shall be applied by the transmission system operator or, as appropriate, the regulatory authorities [99/1133].**

- 130 Article 6 contains transparency requirements. Information must be published that is necessary for network users to gain effective network access.
- 131 Article 8 requires that capacity rights be freely tradable and for operators to facilitate such trading [99/1134-1135].
- 132 Article 9 and the Annex to the Regulation provide for the system of Guidelines which provide the minimum required degree of harmonisation. These specify (among other things) details of third party access services, and details on the technical information necessary for users to gain effective access to the transmission system:

1 **Third Party access services**

- (2) **Harmonised transportation contracts and common network codes shall be designed in a manner that facilitates trading and re-utilisation of capacity contracted by network users without hampering capacity release.**

...

2.1 **Principles underlying capacity allocation mechanisms ...**

- (1) **Capacity allocation mechanisms and congestion management procedures shall facilitate the development of competition and liquid trading of capacity and shall be compatible with market mechanisms including spot markets and trading hubs. They shall be flexible and capable of adapting to evolving market circumstances (emphasis added) [91/993].**

...

- (3) **These mechanisms shall neither hamper the entry of new market participants nor create undue barriers to market entry. They shall not prevent market participants, including new market entrants and companies with a small market share, from competing effectively (emphasis added).**

- (4) **These mechanisms and procedures shall provide appropriate economic signals for efficient and maximum use of technical capacity and facilitate investment in new infrastructure.**

...

- 3.3 ***[technical information necessary for network users to gain effective access to the system]***

- (2) For all relevant points, transmission system operators shall publish available capacities for a period of at least 18 months ahead and shall update this information at least every month or more frequently, if new information becomes available (emphasis added)[99/1137-1140].

133 Article 10 requires national regulatory authorities (such as GEMA) to “ensure compliance with this Regulation” [99/1135].

General principles of Community Law

134 GEMA is also required to comply with the general principles of Community law, including the principle of proportionality; legitimate expectations; legal certainty; non-retroactivity; and equal treatment. In the present case all are engaged.

Wednesbury

135 The Claimants rely on the *Wednesbury* principles, including the duty to take account of relevant considerations, not to take account of irrelevant considerations, and the requirement that decisions should not be irrational in the *Wednesbury* sense.

Consultation duties

136 The Claimants rely on the principles governing proper consultation, including the requirement to provide sufficient information so that consultees can properly respond and the requirement genuinely to take account of consultation responses.

137 *R v North and East Devon Health Authority, ex p Coughlan* [2001] QV 213 at [108] (“To be proper, consultation must be undertaken at a time when proposals are still at a formative stage; it must include sufficient reasons for particular proposals to allow those consulted to give intelligent consideration and an intelligent response; adequate time must be given for this purpose; and the product of consultation must be conscientiously taken into account when the ultimate decision is taken”) ...”

138 *R v Secretary of State for Trade and Industry, ex p UNISON* [1996] ICR 1003, 1015F (Otton LJ: “Under our domestic law fair consultation involves giving the body consulted a fair and

proper opportunity to understand fully the matters about which it is being consulted and to express its views on those subjects, with the consultation or thereafter considering those views properly and genuinely””

Legitimate expectations

139 The Claimants rely on the principles concerning legitimate expectations both under Community law and under domestic administrative law: see Fordham Judicial Review Handbook (4th edn 2004) at Section P41.

Breach of GEMA's duties - summary

140 GEMA's duties and responsibilities set out above have been breached by

- (a) GEMA's decision to amend NGG's Licence to reduce the baseline entry capacity at Teesside from 761 GWh/day to 361 GWh/day so that it became inadequate for the operation of the GasPort;
- (b) GEMA's continuing failure to introduce the capacity transfer obligation;
- (c) GEMA's decisions that modifications proposed to the UNC to introduce the transfer obligation should not be implemented, and in particular GEMA's decision on 12 June 2007 directing that E.ON's Modification proposals 150A and 151A should not be implemented;
- (d) GEMA's ongoing failure to ensure that NGG carried out its undertaking to introduce revisions to the capacity interruptibility regime to satisfy the requirements of the GasPort; and
- (e) GEMA's ongoing failure to ensure that the entry arrangements for the NTS at Teesside enable the GasPort to operate as planned.

141 The further details set out below are without prejudice to the Claimants' reliance on all the legal obligations and responsibilities set out above and the facts set out in these Grounds and in Mr Bryngelson's witness statement.

142 The Claimants' complaints about GEMA's conduct include breach of GEMA's duties under the Gas Act 1986, the Utilities Act 2000, the Directive and Regulation and/or failure properly to take these duties into account; failure to consult properly; breach of legitimate expectation; failure to take into account relevant matters; failure to give proper reasons and Wednesbury irrationality. These grounds overlap on the facts.⁴

Injustice to the Claimants

- 143 Excelerate was encouraged by GEMA to make heavy capital investments in the GasPort, a new and innovative facility, but without any good reason or advance warning, GEMA changed the NTS entry arrangements so that the GasPort was denied the access it requires to the NTS.
- 144 The Claimants are new entrants to the UK gas market. They offer an innovative means of supplying gas to the NTS.
- 145 The GasPort furthers both GEMA's principal statutory objective of promoting competition in the supply of gas, and GEMA's duty to have regard to the need for security of supply.
- 146 The GasPort project was supported both by Ofgem and the Department for Trade and Industry as a means of improving competition in the UK gas market and increasing security of supply as UK continental shelf gas flows decline [66/874].
- 147 The GasPort was constructed because of strong market signals indicating that further gas supplies were urgently required in the UK. Excelerate chose Teesside for the world's first dockside GasPort because of its proximity to the NTS and because there was substantial baseline capacity available which was appropriate for Excelerate's business model of reacting to market signals when deciding where to supply LNG.
- 148 NGG informed Excelerate in October 2005:

From an NTS perspective there is considerable available capacity at Teesside both physically and in today's world more importantly

⁴ "It would be a mistake to approach the judicial review jurisdiction as if it consisted of a series of entirely separate boxes into which the judges dipped as occasion demanded. It is rather a rich tapestry of many strands, which cross, re-cross and blend to produce justice" (*R v SSHD, ex parte Oladehinde* [1991] 1 AC 254 at 280E) per Lord Donaldson MR.

commercially as existing Teesside capacity is a massive 761 GWh/d (approximately 70 mcm/d). Hence from our perspective most if not all issues are 'upstream' of NTS entry. Historically entry flows at Teesside have been as high as 45 mcm/d, current forecasts for 2006/7 are below 30 mcm/d. [7/56].

- 149 The baseline capacity for the GasPort has now been drastically reduced.
- 150 The new baseline capacity limit takes no account of the future capacity requirements at Teesside as a result of the construction of the GasPort. It appears that GEMA simply did not take the known requirements of the GasPort into account when halving the baseline entry capacity at Teesside, although these requirements were known to GEMA and to NGG.
- 151 There is now insufficient entry capacity available at Teesside for imports through the GasPort, should these be called for by the market.
- 152 The effect of GEMA's decision is that whilst capacity lies unused at nearby entry points, there is no spare entry capacity available at Teesside which can be used by the GasPort.
- 153 An integral part of GEMA's TPCR package was the introduction of a capacity transfer mechanism from 1 April 2007 alongside the reduction in baselines. But GEMA has not done this. There are still no transfer mechanisms in place, and the current proposals to introduce a capacity transfer mechanism are sketchy and do not provide any assurance that they will enable the GasPort to operate as planned.
- 154 This outcome is wholly inefficient and cannot be justified or proportionate. It penalises the Claimants, who are new market entrants, for their investment decision, taken in reliance on the encouragement of the DTI and GEMA itself. It discourages future investment in bringing LNG to the UK. It damages competition in the supply of gas and damages the interests of consumers.
- 155 It is wholly unjust.
- 156 While prejudicing the Claimants, these decisions and failures to act by GEMA have benefited NGG, the monopoly NTS operator. NGG was given privileged access to GEMA throughout this process.

The entry capacity baseline at Teesside

- 157 When setting an entry capacity baseline at an NTS entry point for 5 years into the future, it is axiomatic that GEMA must take into account future needs as well as the present position.
- 158 GEMA must also take into account the requirements of suppliers like the Claimants whose operation assists in guaranteeing UK security of gas supply.
- 159 GEMA based its decision to allocate capacity away from Teesside wholly or partly by reference to the long-term capacity previously purchased in auctions at various NTS exit points. If no long-term capacity had been bought, future demand at an entry point was ignored. The flaws in this approach are manifest.
- 160 The previous auctions had been conducted under the 2002-2007 entry arrangements, when Teesside had entry capacity of 761 GWh/day. Purchased long-term capacity is not a legitimate or useful indicator of future demand for capacity, especially in the case of an NTS entry point like Teesside, where the well-known abundance of capacity meant that there was no market signal for shippers to buy advance capacity in the auction. It is not a rational indicator of future capacity requirements at an entry point where there is substantial new investment and forecast supply, as in the case of the Gasport at Teesside. It is not a rational indicator of the future capacity requirements of a new LNG shipper such as Excelerate.
- 161 This is not merely the Claimants' opinion, but also GEMA's view:

7.31 Current auction signals for the five year price control period would be insufficient to accurately reflect forecast demand (TPCR third consultation, paragraph. 7.31 [12/146])

- 162 As Excelerate pointed out in its representations, operators often do not buy long-term capacity, even if they have long-term demand for NTS capacity. With the decline of UK offshore gas production, capacity was readily available in Teesside on a daily basis at low cost. Long-term rights for locations such as Teesside are relatively expensive to buy from NGG in long-term auctions (due to reserve prices), but have no secondary market value. As such, it was economically irrational for LNG shippers such as Excelerate to buy long-term capacity at Teesside. However, the rational decision not to buy long-term capacity says nothing about the potential long-term capacity needs of the GasPort. The effect of GEMA's decision is therefore to penalise the Claimants for responding to market signals and for

rational commercial conduct and discourage a new entrant from building a facility able to provide top-up gas supplies to the UK in times of high demand.

- 163 GEMA has made a general claim that “flow forecast assumptions... were used as an input into the model that developed the baseline proposals” (paragraph 2.12 of GEMA’s 30 March 2007 Reasons [79/913-914]). However, the baseline has been set at a level lower than peak gas flows at Teesside during the 2006/2007 winter months before the GasPort become operational. It is therefore impossible to understand how flow forecasts were in fact taken into account, unless they were considered and then ignored.
- 164 If GEMA based its decision on summer estimates of the NTS’s capacity, this is irrational in the case of Teesside and the GasPort (and very possibly elsewhere) since the winter capacity of the NTS is known to be greater than the summer capacity. The GasPort is designed to supply gas at times of shortage, in particular in winter conditions. If this is the case, it also appears that GEMA failed to consider whether a more proportionate decision would have been the introduction of separate winter and summer entry capacity baselines.
- 165 It is impossible to say what GEMA’s actual reasoning in relation to the GasPort was, as no explanation has been provided as to how (if at all) the GasPort was taken into account in GEMA’s reasoning.
- 166 GEMA recognised that its analysis might need updating to take into account new capacity requirements in the market. In Appendix 9 to its updated proposals (paragraph 1.14 [46/657]) GEMA considered “**sensitivity testing**” of its assumptions to take into account “**new supply and demand scenarios**”. It appears that this was not done. Or if it was done, it wrongly failed to take account of the requirements of the GasPort at Teesside.
- 167 The Claimants and other gas shippers were given no opportunity to protect the necessary capacity at their entry points by purchasing long-term capacity in September 2006 auctions. The first notice GEMA gave that it was proposing setting entry capacity baselines by reference to quantities of capacity already sold at auction came too late for this (see below).
- 168 By using long-term auction signals as a proxy for future demand and by ignoring the position of the GasPort, GEMA has taken into account irrelevant matters and failed to take account of a highly relevant matter.

The transfer obligation

- 169 GEMA reduced the Teesside baseline capacity without introducing any capacity transfer mechanism to allow unused capacity to be transferred to where it was needed. The reduction of the baselines without a compensating transfer mechanism is unjustifiable.
- 170 GEMA itself recognised the need for a transfer mechanism to “**guard against the risk that capacity is ‘sterilised’ at an entry point**” (GEMA’s TPCR Final Proposals, paragraph. 10.8 [52/775]). Accordingly, GEMA planned to introduce a transfer scheme with effect from 1 April 2007, the same date as the changes to baselines.
- 171 The transfer mechanism was an “integral part” of the TPCR package, as GEMA itself has stated – see most recently GEMA’s Open Letter to the industry dated 27 June 2007 [95A/1187A-1187C] and paragraphs 95-98 of the Witness Statement of Robert Allen Bryngelson [4/pages 26-27].
- 172 However, no transfer mechanism was introduced on 1 April 2007, or since. Many respondents in the final consultation expressed the view that capacity transfer needed to be implemented as a matter of real urgency. GEMA did not respond to these concerns at all in its decision notice. No good reason has ever been given for this regulatory *volte face*.
- 173 The consequence is exactly that predicted by GEMA in its own Final Proposals: new gas shippers at Teesside are unable to access capacity they may need whilst significant levels of capacity elsewhere in the same zones of the NTS are unused.
- 174 GEMA’s recent indication in its Open Letter to the industry dated 19 June 2006 that a capacity transfer mechanism should be in place in advance of this winter does not provide the claimants with the necessary security that their position will be protected [95/1080-1087; paragraphs 89-92 of the Witness Statement of Robert Allen Bryngelson [4/pages 24-26]. The Claimants have no idea as to how the transfer mechanism will operate in practice, or whether those terms will be suitable to permit gas flows from the GasPort to the NTS at Teesside at short-notice in response to market changes. Nor is there any security that this timetable can be achieved – NGG itself expressed doubts about this in its own letter of 4 May 2007 [83A/1007A-1007B]. In any event, current discussions on a possible capacity transfer mechanism are only in relation to a mechanism for this forthcoming winter and not an

enduring solution consistent with the TPCR's 5 year baselines. There is no timetable for such discussions at present.

Baseline capacity, the transfer scheme and the auctions

- 175 On 26 September 2006 (a) GEMA published its proposal that no baseline would be below purchased long-term capacity [45/644]; and (b) the September LTSEC auction closed. The timing meant that the Claimants had no time to react to GEMA's announcement and purchase long-term capacity to protect Teesside's entry capacity and the large capital investment in the GasPort, despite Teesside capacity being available in that auction. There were no market signals that the Claimants needed to purchase capacity in that auction, because there was plentiful capacity at Teesside and GEMA's own indicated baseline for Teesside was at that date fully ample to meet the GasPort's requirements. At the time of the September auction, capacity rights had no secondary market value which deterred all Teesside gas shippers from making significant long-term capacity commitments.
- 176 On 17 January 2007, GEMA took an urgent decision to amend the UNC to delay the February 2007 AMSEC auction. These would have taken place on the basis of the Licence Conditions which were lawfully effective on that date – including the specification in Table A2 of the Licence Conditions that Teesside had a baseline entry capacity of 761 GWh/day. By delaying this auction GEMA deprived the Claimants of a final opportunity to purchase 24 months capacity for the Teesside GasPort before the baselines were reduced [61/834-836]. Again, an opportunity for gas shippers to buy appropriate NTS capacity to secure their position was lost. The reason given for this change was to ensure that NGG did not have to offer baseline capacity that GEMA was minded to reduce (Urgent Modification Proposal 129 [61/834-836]).
- 177 The AMSEC auction which GEMA delayed from February 2007 was held in May 2007, on the reduced Teesside baseline, and without the transfer obligation in place. At the time when GEMA delayed this auction, the transfer obligation was an integral part of the TPCR package. But (as noted above) the transfer obligation was not introduced at the same time as the baseline capacity reductions.

- 178 Further, on 8 May 2007, shortly before the auction took place, GEMA decided to reject urgent Modification Proposal 138 to the UNC which would have introduced a limited capacity trading scheme to enable shippers holding rights to entry capacity at multiple entry points to reallocate that capacity between the different entry points [84/1008-1010]). GEMA stated that it “is proposing to introduce obligations on NGG NTS to facilitate capacity trade and produce a capacity trade methodology through a modification to NGG NTS’s gas transporters licence, such an obligation is to be introduced with retroactive effect from 1st April 2007”. However, no such obligation has yet been introduced.
- 179 It is unclear what (if any) “retroactive effect” any such proposed obligations will have from 1 April 2007.

Breach of the Gas Act 1986

- 180 Under Section 4AA of the 1986 Act, GEMA has primary objectives to protect the interests of consumers, promote competition, efficiency and economy, and ensure that reasonable demands for gas are met (see above). These provisions are not merely unenforceable aspirations. They are substantial and binding duties.
- 181 GEMA must (a) take these duties into account when taking decisions; and (b) give cogent reasons for any non-compliance. See, for example *R (Elias) v Secretary of State for Defence & Commission for Racial Equality* [2005] EWHC 1435 (Admin) (unsuccessfully appealed by the Secretary of State on different grounds at [2006] 1 WLR 3213) where Elias J held that the comparable duty on public bodies to promote good race relations was an important and substantial obligation that had been breached. Compliance requires a “careful attempt to assess whether the scheme raised issues relating to racial equality” [98]. It is also important that proper consideration takes place at the time the decision is made [99].
- 182 The sterilizing of the GasPort by the reduction of the Teesside baseline without introducing a mechanism for capacity transfer which would enable the GasPort to operate as planned, amounts to a plain breach of GEMA’s duties under section 4AA of the Gas Act 1986, and also of GEMA’s duty to ensure that NGG complies with its similar duties under section 9 of the Gas Act 1986.

183 The reduction in baselines operates to the detriment of UK consumers who want and need access to potential sources of gas at times of peak demand when prices are high without the risk of interruptions in supply.

184 Free competition in gas supply and economic efficiency are undermined. At present, capacity cannot be utilised where there is demand. Instead, it is left unused at other locations and cannot be transferred to where it is needed most. Such an outcome is highly inefficient. Reasonable demands for gas that the GasPort was created to serve may not be met.

Breach of the better regulation duty under Section 4AA(5A).

185 The Secretary of State for Trade and Industry has cited the GasPort as an example of open markets and predictable regulation producing economic efficiency and benefits for consumers [66/874-876].

186 GEMA's decisions and failures which are the matters of complaint in these proceedings have the practical effect of sterilising the GasPort. They are contrary to the principles of better regulation, and GEMA's duty, when exercising its statutory powers, to have regard to the principles of good regulatory practice: section 4AA(5A) of the Gas Act, inserted by the Energy Act 2004) [96/1089].

187 GEMA's conduct in reducing the baselines without also introducing a fair capacity transfer mechanism was not transparent, accountable, proportionate or consistent. Instead of introducing a coherent regulatory package, GEMA has introduced its TPCR reforms in a piecemeal manner. An important mitigation measure (capacity transfer) has been delayed, exposing the GasPort to the full impact of the reduction in its baseline capacity. Such a position cannot sensibly be described as good regulation – it was not transparent, proportionate, consistent or effectively targeted.

Breach of Condition A11 of the Licence

188 GEMA's decision on 12 June 2006 to reject Modification Proposals 150A and 151A to the UNC was contrary to the requirements of Condition A11 of the Licence, including the

“relevant objectives” in Condition A11. These Modification Proposals would have better facilitated the relevant objectives than the current wholly unsatisfactory state of affairs, where the baseline capacity reductions are in place but the transfer mechanism is not.

- 189** In particular, these Modification Proposals would better facilitate relevant objectives (a) (the efficient and economic operation of the NTS); (c) the efficient discharge of NGG’s obligations under the Licence; and (d) the securing of effective competition between shippers and suppliers. GEMA failed to compare these Modification Proposals to the current position as it was required to do by Condition A11.

Breach of EC law

- 190** The matters of complaint, including the reduction in baselines without a proper capacity transfer system, also breach GEMA’s duties under the Directive, the Regulation and the general principles of EC law. The relevant EC law duties are set out above. The following is without prejudice to the Claimants’ reliance on all of those duties.
- 191** The Regulation imposes directly effective legal obligations on GEMA, which is bound by it (section 4B(4) of The Gas Act 1986) [96/1091]. The Directive is clear and certain and also has direct effect on GEMA, a public body.
- 192** The Court will not merely review GEMA’s decision on domestic public law grounds. It will apply the principles of Community law in construing and applying the Regulation, including proportionality, legal certainty, non-retroactivity and equal treatment.
- 193** It is insufficient for GEMA to simply claim that its decision was one that a reasonable regulator could have reached. The Court will apply a more demanding standard than domestic Wednesbury unreasonableness. See *R v Secretary of State for Health, ex parte Eastside Cheese Company* [1999] EuLR 968, CA.
- 194** The matters of complaint (including the baseline reduction at Teesside and the continuing failure to introduce a transfer scheme) plainly breach of GEMA’s duties under the Regulation.

- 195** The process of setting baselines, and the entry arrangements which have resulted, are discriminatory. They discriminate in favour of operators at locations where long-term capacity has previously been purchased – an irrelevant factor, for the reasons given above. They protect incumbents against new entrants because GEMA allocated to each entry point at least the amount of capacity already sold and the amount of capacity which NGG is obliged to release in auction at each entry point is reduced by the amount already sold. They have a serious anti-competitive effect on new market entrants, such as the Claimants. The effect on a supplier who enters the market to provide capacity at times of peak demand is particularly severe, despite such suppliers being needed to secure the UK's energy supplies. They undermine competition in gas supply.
- 196** The lack of a capacity transfer system and the low baselines mean that the changes do not ensure the maximum use of available NTS capacity and are economically inefficient. The system is neither flexible nor adaptable. In addition, the continuing uncertainty over the enduring transfer/trading system makes it impossible for Excelerate to know what position to take in the forthcoming September 2007 long term entry capacity auctions.
- 197** The continuing failure to introduce the capacity transfer obligation also amounts to unjustifiable discrimination – it prevents new entrants from effectively competing with existing shippers.
- 198** The current entry arrangements and the proposed modifications to them lack transparency. This, together with the complexity of the proposed arrangements, further discriminate against (1) new market entrants and (2) small parties such as the Claimants. These are disadvantaged by the current wholly uncertain position on NTS entry arrangements. They will also be disadvantaged by the complexity of the analysis and bidding decisions and the setting of 'exchange rates' between a large number of entry points.
- 199** The decision-making process and the current regulatory position which has resulted lack transparency. The criteria GEMA adopted were not announced in good time prior to their adoption. The decision to set baselines on long-term bought capacity was made so late so that it was practically impossible for firms to adjust their commercial position by bidding in either recent long-term auction. Prior to the announcement, there were no efficient market signals indicating that the Claimants should participate in the auction, given the plentiful

long-term capacity available at Teesside. It is entirely unclear how the baselines were actually set, or what adjustments were made following private discussions between GEMA and NGG.

- 200 The current regulatory position is also wholly unclear. The industry is effectively forced to operate on the basis of entry arrangements which are admittedly incomplete, where the details of the missing pieces are not known, and where a wholly vague indication has been given that there will be some retroactive effect.

Consultation and Procedural Fairness

- 201 A balanced and transparent consultation is an essential part of fair decision-making process. However, the consultation process here was neither open nor balanced.
- 202 Sufficient information was not given to consultees, including the Claimants to enable them to respond effectively on the reduction of the Teesside entry capacity baseline or on the effect of this reduction without an effective and enduring capacity transfer and trading mechanism.
- 203 In its 15 March 2007 consultation response, Excelerate expressed its concerns about the lack of evidence shown to shippers, especially as to the baseline calculation methodology [71/889-890].
- 204 It appears that this methodology was developed in private between Ofgem and NGG. It has still not been made public in full. In its final proposals, GEMA refers to (unspecified) adjustments made in a “small” (but unspecified) number of cases to deal with (unspecified) zonal constraints (GEMA’s final proposals, paragraph. 1.11 [52/786]), reached following (unspecified) discussions with NGG.
- 205 Such private, one-sided, consultations on important issues are unfair and unlawful. They are incompatible with GEMA’s duties to be open, transparent and to hear both sides. See, for example, *R (Corner House Research) v Secretary of State for Trade and Industry* [2005] 1 WLR 2600, CA at [85, 138-9] (Export Credit Guarantee Department unlawfully granted privileged access to large customers, whilst excluding pressure groups from same discussions).
- 206 The dangers of privileged access are even greater when, as here:

- (a) the privileged access is granted to a monopolist whom GEMA is supposed to regulate in the public interest, not agree private deals with;
- (b) the excluded parties are those subject to the monopolist's power; and
- (c) the excluded parties include new entrants (the Claimants), with limited market share and extremely limited market power.

Reasons

207 The reasons given by GEMA for its decisions of 30 March 2007 and 12 June 2007 are inadequate, do not respond adequately to the points made by consultees and do not conform with the requirements of Section 38A of the Gas Act.

Impact Assessment

208 Section 5A of the Utilities Act 2000 requires an impact assessment of important proposals, including proposals which will have a significant impact on shippers.

209 GEMA's proposals have changed beyond recognition as the consultation process has proceeded. Initially, GEMA considered abandoning the concept of baselines altogether. Later, the proposal was for a modest reduction in baselines, combined with capacity transfer. At a later stage, much larger cuts in the baselines were announced, but still with capacity transfer. Eventually, GEMA implemented the baseline reductions, but without any capacity transfer system.

210 A partial impact assessment accompanied GEMA's initial proposals. It was premised on the basis that there would be a capacity transfer system (Appendix 12, paragraph. 1.71 [17/277]). Accordingly, it is common ground that the proposals were 'important' and a proper process of impact assessment was required under Section 5A.

211 No impact assessment was carried out for the eventual proposal – baseline changes without capacity transfer. The consequences of the proposal were undoubtedly significant, and an impact assessment should have been carried out with the results subject to a proper consultation. The failure to do so was unlawful – it was breach of public law standards of fair consultation and of section 5A of the Utilities Act 2000.

212 Had an assessment been carried out, GEMA would have better understood the serious consequences of its proposals. An impact assessment is not a mere formality, but an essential part of a fair decision making process. See *Berkeley v SSETR* [2001] 2 AC 603, HL (grant of planning permission quashed due to failure to consider whether to carry out environmental impact assessment).

Legitimate expectations

213 GEMA was at all times aware of the GasPort. During the construction of the GasPort, Excelerate gave presentations to Ofgem and provided regular monthly updates which included statements as to the GasPort's capacity (for example, (Excelerate's presentation to Ofgem on 15 August 2006 [27/459-479]).

214 Ofgem was highly supportive of the GasPort project and never warned that changes might be made to reduce the Teesside entry baseline capacity so as to render the planned operation of the GasPort impossible.

215 Excelerate relied on Ofgem's support for the project in deciding to construct the GasPort. In these circumstances, it would be an unfair abuse of power for GEMA to change the regulatory scheme so that the GasPort cannot operate or for GEMA to maintain the present unfair position.

D. Timing

216 Excelerate's solicitors, Watson Farley and Williams LLP sent GEMA a detailed letter before claim on 13 June 2007 [92/1065-1077]. The Claimants rely upon the matters of complaint set out in this letter.

217 In their reply dated 19 June 2007, GEMA's solicitors Herbert Smith LLP did not provide any answer to any of the substantive points made in the letter of claim (and no answer has been received subsequently). Herbert Smith LLP's letter reserved their clients' position on the question of delay.

218 The Claimants have brought these proceedings promptly and within three months of the various matters of complaint. The matters of complaint are inextricably interlinked. The current NTS entry arrangements are the result of their combined effect. GEMA's decision

reducing the baseline capacity for Teesside was announced on 30 March 2007. The failure to implement a capacity transfer mechanism is an ongoing complaint. GEMA's decision to reject Modification Proposals 150A and 151A to the UNC to introduce a transfer mechanism was taken on 12 June 2006. Throughout this period the Claimants have been taking reasonable steps to achieve, with other industry parties, a practical solution without litigation. The position is further addressed in Mr Bryngelson's witness statement at paragraphs [81 to 103].

219 The Claimants have exhausted all other method to remedy the serious injustice in this case. Judicial review is a last resort where other methods have failed. Those measures having been tried, the Claimants have been left with no option but to commence proceedings.

E. Conclusion

220 For the reasons set out above, the Court is invited to grant permission, and in due course, the relief sought.

ALAN GRIFFITHS

BEN JAFFEY

SERVED this 29th day of June 2007 by Watson Farley & Williams LLP of 15 Appold Street, London EC2A 2HB. Solicitors for the Claimants.

IN THE HIGH COURT OF JUSTICE
QUEEN'S BENCH DIVISION
ADMINISTRATIVE COURT

B E T W E E N:

THE QUEEN

on the application of

(1) EXCELERATE ENERGY LIMITED
PARTNERSHIP

(2) SEAL SANDS GAS
TRANSPORTATION LIMITED

Claimants

- and -

GAS AND ELECTRICITY
MARKETS AUTHORITY

Defendant

STATEMENT OF
GROUNDS FOR JUDICIAL REVIEW

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