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Mr J. Majdanski
Secretary, Modification Panel
Joint Office
National Grid

Friday, 03 March 2006

Dear Julian

Re: UNC Modification Proposal 0073 - "Revision to the Notice Period regarding the implementation of changes to Transportation Charges"

Thank you for the opportunity to comment on this Modification Proposal.

National Grid NTS does not support implementation of the Proposal as, in its view, it would hamper its ability to comply with its GT Licence objectives, and it would not further the relevant objectives set out under Standard Special Condition A11 of its GT Licence.

At present, National Grid NTS' GT Licence contains provisions governing its level of allowed revenue, the process by which it reports on performance against its revenue controls, and the process to be followed when amending the level of transportation charges. This is consistent with the regulatory frameworks of other UK gas transporters. However, while the Licence requires one month's notice to be provided for changes to transportation charges, two is actually given in accordance with the provisions of the UNC.

The setting of prices involves uncertainty surrounding the estimates used of allowed and collected revenue and other input data. We consider that the two months notice period has worked well in the past as a good compromise between an adequate period of notice and getting the price changes as accurate as possible in order to keep collected and allowed revenue aligned. Increasing the notice period to four months, as contemplated by the Proposal, however would bring about a number of consequences that could be seen as counter-productive to charge stability, since giving earlier notice would reduce the information available to transporters at the time that changes to transportation charges are being set.

As an example, around 50% of the SO commodity charge seeks to recover shrinkage costs in the NTS, which is heavily dependant on gas costs and thus difficult to forecast accurately. In 2005, National Grid NTS notified the Industry on 1 May of an expected increase in the SO commodity charge to take effect from 1 October within the range 10% - 20%. By 1 August when final prices were published this had been revised to an increase of 35%. Had a four month notice period been in place, then the SO commodity charge set from October to March 2006 would have been around 20% below the level that would otherwise have been the case.

As a further example, the setting of appropriate TO exit capacity charges requires access to the most up to date demand forecast information. This is agreed annually as part of the Industry wide TBE ("Transporting Britain's Energy") consultation process, and permits the demand supply statements to be completed in May. A notice period of four months, requiring final charges to be announced by 1 June, would not allow sufficient time to utilise the information

obtained from the outcome of the demand forecasting cycle when calculating the new charges, thus necessitating the use of the previous year's demand forecasts. The variation between one year's forecast demand figures and the next, for a typical year, can be up to 2%, and therefore this approach could have an adverse impact on the level of 'K', and would hamper National Grid NTS' ability to set charges using the most accurate cost-information.

The setting of appropriate transportation charges also requires an understanding of any carry over of under/over-recovery (or 'K') from the previous financial year. As this figure is not determined and approved until May each year, this would imply that the process of calculating final prices (in late April/May to meet a 1 June deadline) would be undertaken prior to the finalisation of the "outturn" level of 'K' for the previous financial year. In our view, this would create greater uncertainty in the current level of 'K', thus adding to the difficulty in setting prices to align collected revenue with allowable revenue.

Although recognising the perceived benefits that the Proposer has suggested would arise from implementation, National Grid NTS believes that this would only provide certainty in charges in the short term and thus would benefit only those shippers who set supply contracts with consumers at short notice (e.g 2-3 months) and on a frequent basis. However, we believe that this would be outweighed by the detrimental effects on gas supply contracts due to the increased volatility and lack of certainty in transportation prices that would arise in the medium to longer term.

Taking the above points into consideration, it is National Grid NTS' view that implementation would lead to consequential impacts in the following areas :

- Greater forecasting uncertainty – due to reduced information being available at the time that charges are set
- Price volatility – since increased forecasting errors would generate greater levels of 'K', leading to larger subsequent corrections in charges
- Frequency of price changes – as a result of greater volatility in charges, it is more likely that we would need to change charges twice per year
- Price certainty – at the four month notice period, the confidence in the appropriateness of the published final prices would not be significantly greater than that for the 150 day (5 month) indicative notice.

Consequently, implementation of the proposal, in National Grid NTS' view would be to the detriment of the following relevant objectives :

A11.1 (d) - the securing of efficient competition between relevant shippers, suppliers and DN operators. Due to National Grid NTS' licence obligation to set prices to recover allowable revenue, implementation would be expected to lead to an increase in price volatility and uncertainty thus frustrating competition in the gas supply market. Additionally, the reduction in cost-reflectivity of transportation charges could lead to inappropriate cost-targeting between market segments, and hence may be considered to be inconsistent with facilitating effective competition.

A11.1 (c) - The efficient discharge of the licensee's obligations under this Licence. Implementation of this proposal would impact on cost reflectivity in transportation charges as setting charges earlier would lead to the use of less accurate demand forecasting data. Furthermore, Standard Special Condition C8B (1) of the Licence states that transportation owner activity revenue shall not exceed the maximum allowed revenue. Earlier charge setting would increase the risk of potential breach of this licence objective.

In summary, for the reasons outlined above, National Grid NTS does not support implementation of this modification proposal. Please let me know if you, or the SME assigned to this Proposal, requires any further information to enable preparation of the Final Modification Report.

Yours sincerely

Paul Roberts

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National Grid NTS