NTS Firm & Interruptible Entry Capacity Discounts and Spare Capacity

Gas TCMF

8th April 2008

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Holistic Overview

- Access arrangements should be based on:
  - **User commitment**: Long-term user commitment to underpin investment to avoid significant transfer of stranding risk to customers.
  - **Strong financial incentives on NG to make new capacity available/deliver new investment on time**
  - **Incentives on NG to release further non obligated capacity** closer to real time **and/or**
  - **Tradeable rights** at and across entry points with mechanisms to ensure capacity is not hoarded or sterilised

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Role of the Market v National Grid

High Market/Low National Grid

- NG release capacity based on l-term signals
- NG obliged to release firm capacity up to baseline
- NG facilitates trades and transfers
- National Grid does **not** release any interruptible capacity – left to secondary market
- Increased transparency in holdings to help facilitate trades between market participants

Low Market/High National Grid

- NG release capacity based on l-term signals
- NG obliged to release firm capacity up to baseline
- NG releases further non obligated firm capacity
- NG has UIOLI obligations to release capacity
- NG releases discretionary interruptible products
- NG facilitates trades and transfers

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Clearing Allocation Obligation - Problems

- Zero reserve price for capacity sold on the day coupled with an obligation to offer for sale the baseline level of capacity (which is sometimes above physical capacity):
  - does not encourage long-term bookings;
  - does not encourage liquidity in the secondary market;
  - can result in under-recovery against the TO MAR, which leads to an increase in the TO commodity charge (payable on entry flows);
- Suggest that the obligation is removed and National Grid applies a reserve price for daily capacity as for other timeframes
- Potentially seek to price interruptible product providing opportunity for product differentiation

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Interruptible Capacity & Secondary Market

- UIOLI
  - Rationale behind the UIOLI product was as an anti-hoarding device;
    - Potentially still warranted today and is required to comply with EU Regulation.
    - Could it be sharpened to stimulate the secondary market as the “lose it” does not bite?
    - Quantity: Is zero priced interruptible appropriate if firm still available at the ASEP or in the locality?
- Discretionary interruptible
  - Product introduced given the potential issues identified during implementation of T&T for winter 2007/8 .
    - Enduring merit depends on the outcome of the discussion on National Grid’s role.
- Secondary markets
  - Varying degrees of satisfaction with the operation of the secondary market within the industry. Two schools of thought:
    - National Grid capacity releases inhibit the market
    - National Grid capacity releases (eg the new product, discretionary interrruptible) provide viable alternatives where secondary market is not providing a viable option

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Price Discounts Summary

- Removal of reserve price discounts day-ahead and on the day to further encourage long term bookings
- Potentially seek to price interruptible product providing opportunity for product differentiation
- Substitution may well provide a significant solution to the ‘spare capacity’ charging issue (i.e. charges linked to obligated rather than assumed flows).
- Additional charging enhancements could be made to incentivise long term booking of existing “spare capacity” e.g. QSEC discounts

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Spare Capacity & QSEC Discounts

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What is Spare Capacity

- Spare System Capacity:
  - Un-used physical capacity in an individual pipe or a sub-network i.e. series of connected pipes?
- Or
- Spare Entry Capacity
  - Commercial

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Spare System Capacity

- Transcost approach
  - Leads to unstable prices
  - Highly influenced by network configuration (discretion of the analyst) and therefore
    - Not transparent or replicable
    - open to industry criticism.
  - Prices no longer reflect costs incurred so not appropriate for Exit
    - Not an issue for Entry reserve prices under the Licence but what about the EU Regulations?)
- Transportation Model approach used previously for Electricity Transmission
  - Reduced line lengths (75%) were included in the Electricity TM to represent spare capacity in the south west – but removed as part of BETTA.
  - Reduction arbitrary and identification of lines to reduce is either arbitrary or involves complex network analysis hence
    - Not transparent or replicable
    - open to industry criticism.

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Spare Entry Capacity

- What is Spare Entry Capacity?
  - Un-utilised Entry Capacity at an ASEP?
    - We don't know this until after the day and hence is of no value in regard to forward charge setting
  - Baseline Entry Capacity less forecast entry flows?
    - This was the GCM06 proposal which was vetoed
    - Only way to take into account 'spare capacity' in investment timescales
    - Forecasting becomes contentious
    - Undermines TBE
  - Unsold Obligated Entry Capacity?
    - This is what we sell in every auction at every ASEP

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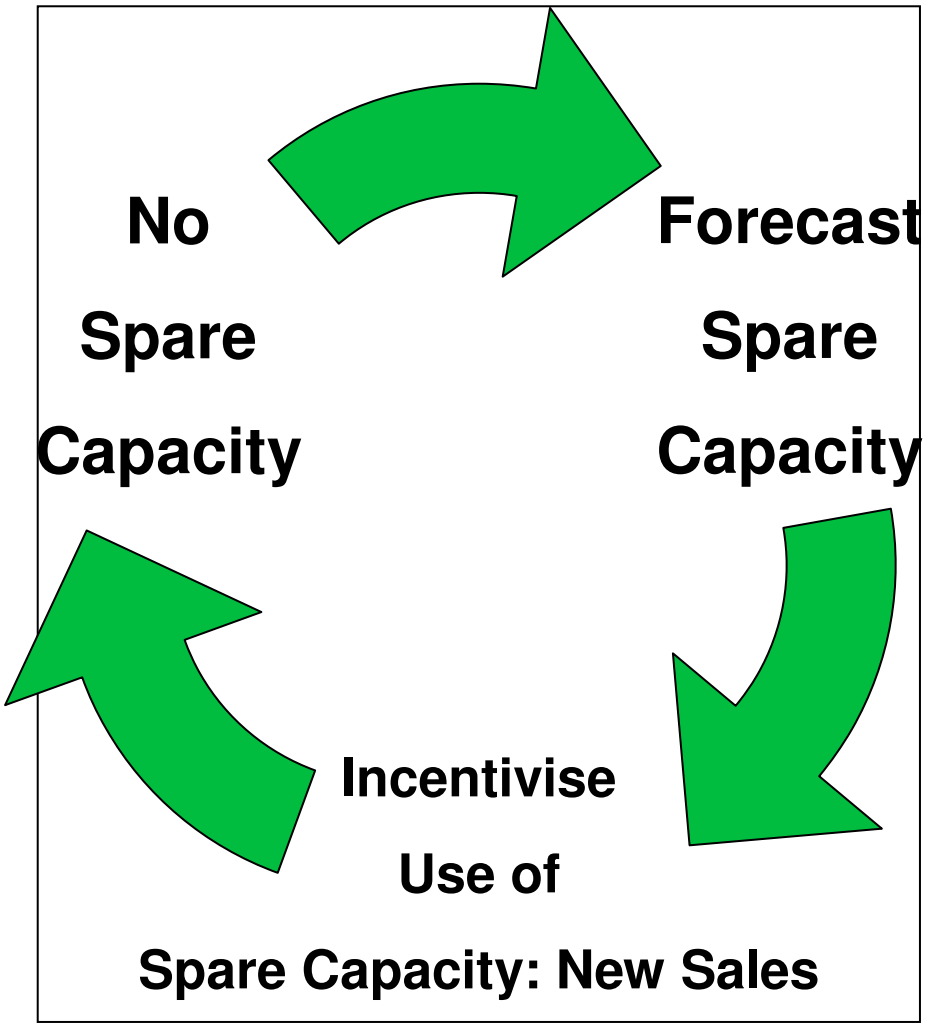
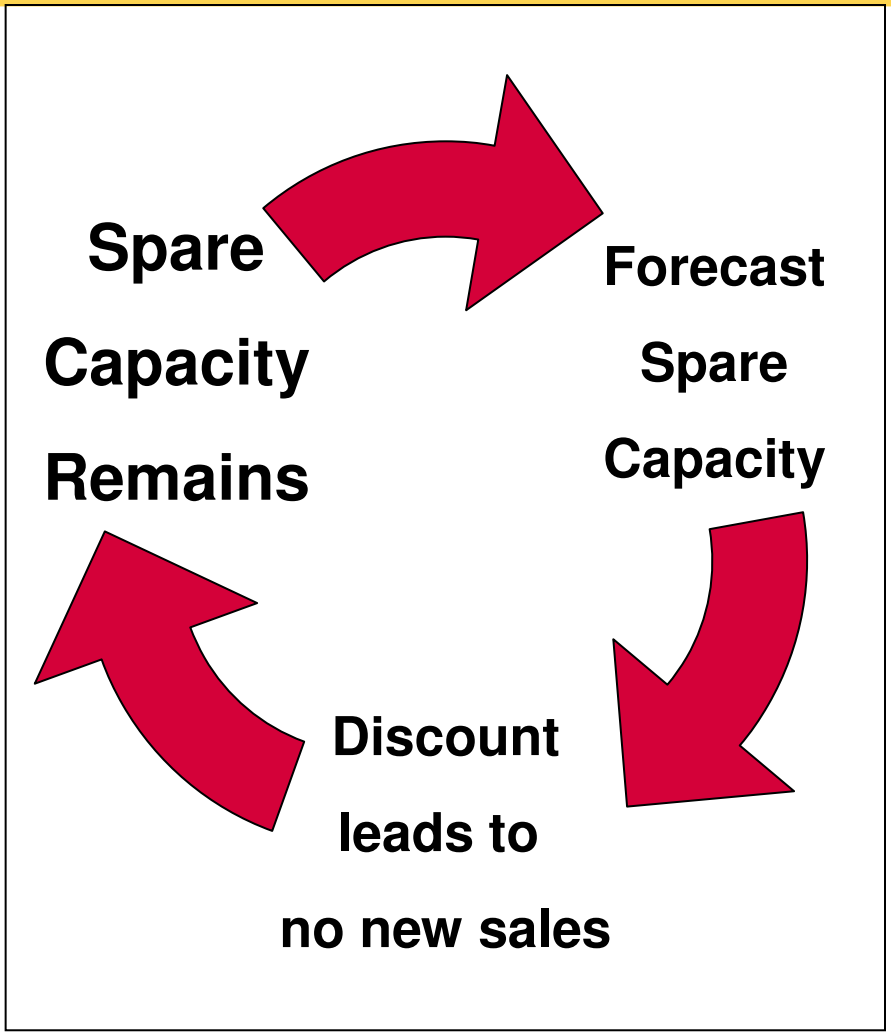
Forecast Loop





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Forecast Loop Outcome

- Success – Increased 'Spare' Capacity Sales
  - Discounts for new capacity

  …but discounts for capacity that would otherwise have been sold

  … new sales would need to outweigh discount otherwise

  …cross subsidy from other Users

  - Capacity utilised is in excess of the forecast

  …the forecast is incorrect

- Failure – No increase in 'Spare' Capacity Sales
  - Discounts for capacity that would otherwise have been sold

  … cross subsidy from other Users

  - Capacity utilised similar to the forecast

  …the forecast is viewed as being correct

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Spare Capacity Conclusion

- We have not identified a useful forward looking definition of Spare Capacity for charge setting purposes other than that based on a forecast
  - Proposing using forecasts in the charging model led to accusations of manipulation and pollution of the TBE process and unstable pricing
  - GCM06 did not gain support from the industry for this reason
- We should be focusing on incentivising the use of existing capacity within investment time scales
  - i.e. obligated entry capacity ~ P0 QSEC prices
- We must be mindful that any capacity discounts will lead to TO Entry Commodity Increases unless new sales outweigh the discounts

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QSEC P0 Options

- P0 prices are currently set using the Transportation Model with the relevant entry point at the obligated level
  - 10% Discount
    - We only offer 90% of the obligated level in the QSEC hence we could reduce to this level (which would reduce prices) or simply offer a 10% discount
  - Other
    - Views?

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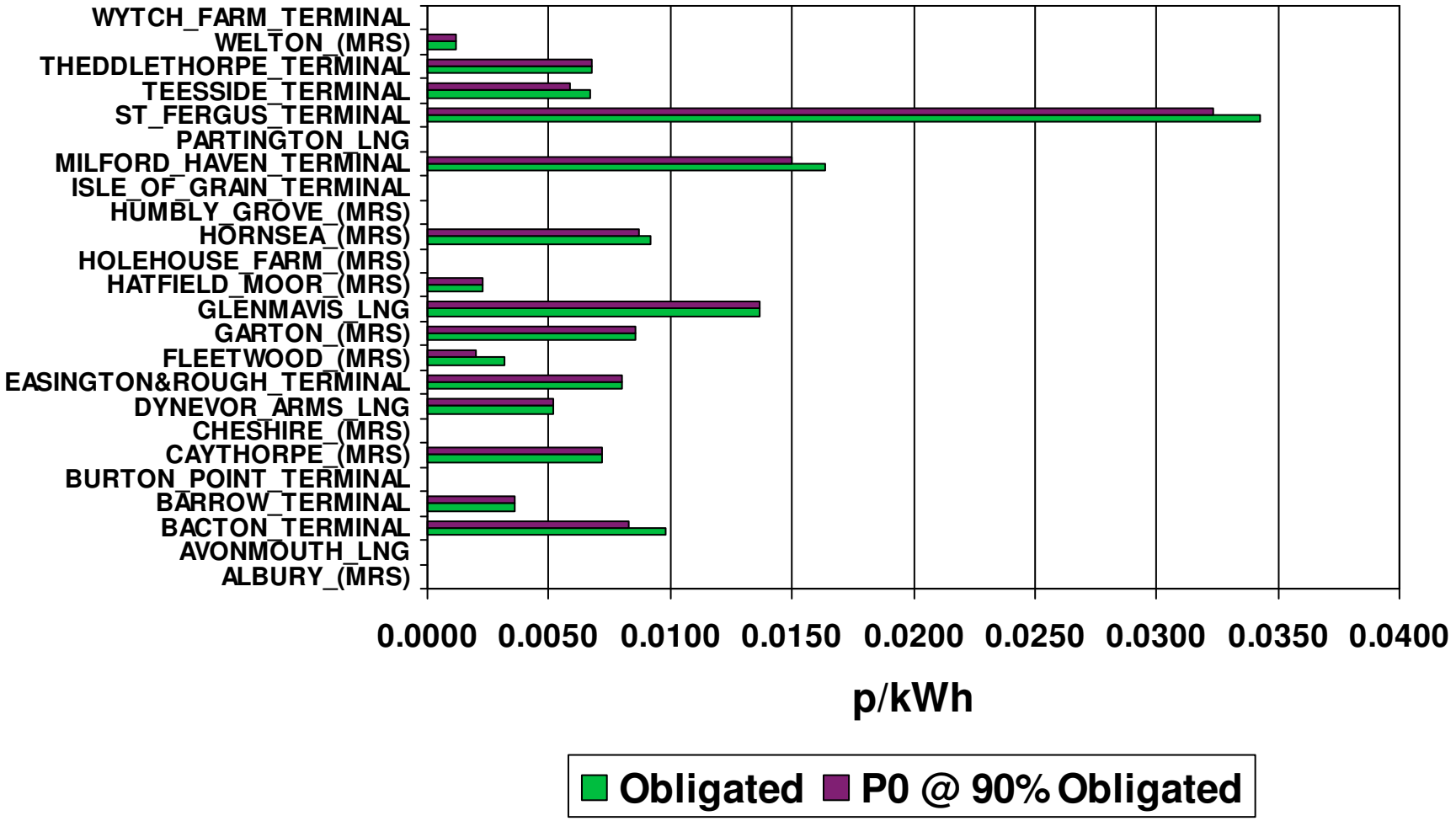
Impact on 2007 QSEC P0 Prices



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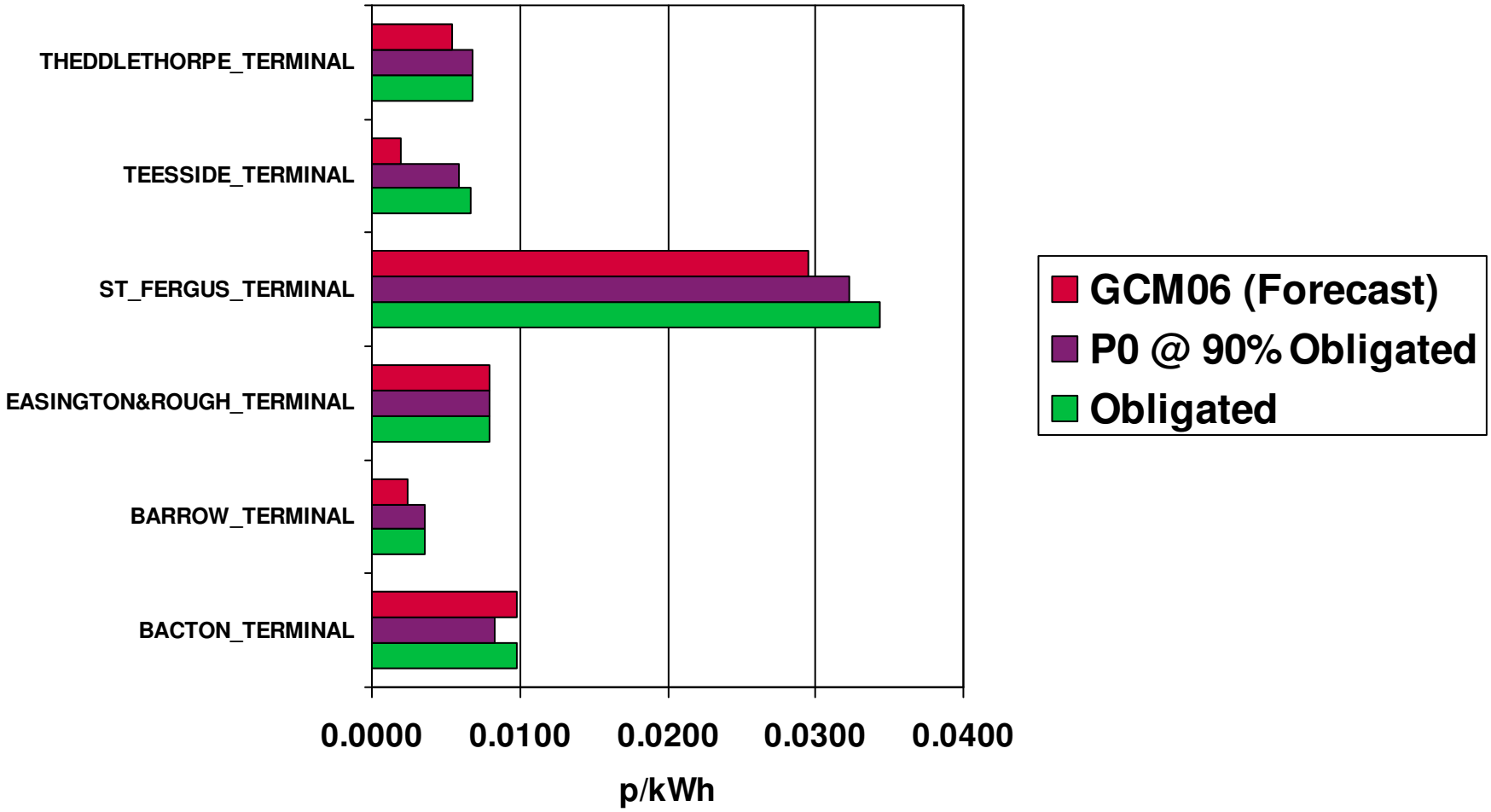
Impact on 2007 QSEC P0 Prices - Beach



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Consultation Options

- Discussion followed by Consultation
- Draft Consultation for comment followed by Consultation
- Straight to Consultation

Views?

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Potential Charging Methodology Proposal Timeline

Milestone	Date
Charging Methodology Proposal issued	November 2008
Consultation Ends	December 2008
Consultation Conclusions Report inc. Final Proposals	January 2009
Ofgem veto period ends (Assumes no Impact Assessment)	January 2009
Notice of Charges	1st February 2009
Implementation	1st April 2009

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