

CONCLUSIONS REPORT TO THE AUTHORITY

Modification Proposals to the Gas Transmission Transportation Charging Methodology

NTS GCM 04:

**Introduction of NTS Exit (Flexibility) Capacity
Charges under the enduring offtake arrangements**

10th May 2007

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1 Executive Summary

This document sets out National Grid NTS's final proposals for modification of the Gas Transmission Transportation Charging Methodology (the "Charging Methodology") in respect of the setting of NTS Exit (Flexibility) Reserve Prices following the completion of a 28 day consultation on Consultation Paper NTS GCM 04.

These Reserve Prices are required as a result of the implementation of UNC Modification 0116V ("Reform of the NTS Offtake arrangements"), which makes available an NTS Exit (Flexibility) Capacity product to all Users as part of the enduring offtake arrangements. This product will be made available on a zonal basis with NTS Exit Zones as defined in the Exit Capacity Release Methodology Statement (ExCR). The first annual auctions for the release of NTS Exit (Flexibility) Capacity would be held in July 2008.

National Grid NTS published a pricing discussion paper NTS GCD 02 in October 2006 on the setting of reserve prices for both annual and daily auctions of NTS Exit (Flexibility) Capacity. Recognising the support given to the NTS Exit (Flexibility) Capacity reserve price proposals contained within the discussion paper NTS GCD02, National Grid NTS proposed through consultation paper GCM04 that:

- a zero reserve price will be applied for NTS Exit (Flexibility) Capacity at all NTS Exit Zones for the annual and daily auctions.

In light of representations received, National Grid NTS continues to consider that implementation of this proposal would better achieve the relevant methodology objectives (under National Grid NTS's GT Licence obligation Standard Special Conditions A5)

National Grid NTS notes that E.ON UK plc has submitted an Application for permission to appeal to the Competition Commission regarding the Authority's decision to implement UNC Modification 0116V. If the appeal is granted and if the outcome of the appeal warranted it, National Grid NTS would conduct further consultations on its Charging Methodology as necessary.

2 Introduction

- 2.1 National Grid NTS proposed UNC Modification Proposal 0116V "Reform of the NTS Offtake Arrangements" in respect of the release of Exit Capacity for utilisation from 1st October 2010. The proposal was directed for implementation on 5th April 2007 with implementation deferred until 1st April 2008 and hence in respect of the release of Exit Capacity for utilisation from 1 October 2011. As a result, National Grid NTS will make available a capacity product referred to in the proposal as "NTS Exit (Flexibility) Capacity".
- 2.2 In light of the implementation of this product, National Grid NTS is required by Standard Licence Condition A4 of its GT Licence to consider any associated changes to the Gas Transmission Transportation Charging Methodology (the "Charging Methodology").
- 2.3 National Grid NTS notes that E.ON UK plc has submitted an Application for permission to appeal to the Competition Commission regarding the Authority's decision to implement UNC Modification 0116V. If the appeal is granted and if the outcome of the appeal warranted it, National Grid NTS would conduct further consultations on its Charging Methodology as necessary.

- 2.4 National Grid NTS has already consulted on NTS Exit (Flexibility) Capacity pricing arrangements through pricing discussion paper NTS GCD 02 published on 20th October 2006 with the consultation period ending on 24th November 2006. The consultation covered the setting of reserve prices for both annual and daily auctions of NTS Exit (Flexibility) Capacity. Respondents were supportive of the setting of a zero reserve price for annual and daily NTS Exit (Flexibility) Capacity and hence National Grid NTS continued this option through charging methodology consultation GCM04. Appendix A to this document provides a summary of the relevant discussion papers published in respect of the enduring offtake arrangements and industry representations.
- 2.5 A number of other transportation charging methodology modifications will be required to support implementation of the enduring offtake arrangements. These issues will be discussed in a related consultation paper NTS GCM 05, "Introduction of NTS Exit (Flat) Capacity Charges under the enduring offtake arrangements".
- 2.6 National Grid NTS issued Pricing Consultation NTS GCM 04, covering the setting of NTS Exit (Flexibility) reserve prices on 23rd February 2007 with the consultation period ending on 23rd March 2007.
- 2.7 This report covers the terms of the original proposals, the representations made by relevant parties and whether changes in the terms of the proposal made by National Grid NTS should be made as a consequence of representations received.

3 Background

- 3.1 UNC Modification Proposals 0116V, "Reform of the NTS Offtake Arrangements" introduces common exit capacity products and registration processes for all Users under the enduring offtake arrangements, commencing operation from 1st October 2011. This section sets out relevant background information in respect of these proposals to help respondents to this consultation.

Capacity Products

- 3.2 Both an NTS Exit (Flat) Capacity product and an NTS Exit (Flexibility) Capacity product are introduced as described below:
 - **"NTS Exit (Flat) Capacity"** - to provide Users the ability to obtain rights to offtake a daily quantity of gas at an NTS Exit Point, with the implied right to offtake at an even flow rate across the Gas Day. This in effect extends the current NTS Offtake (Flat) Capacity available to DNO Users at NTS/LDZ Offtakes to all Users and all NTS Exit Points. Such a product is anticipated to provide National Grid NTS with clear locational signals for where, when and how much transportation capability may be required by Users to support anticipated end of day demand, and will facilitate efficient NTS investment planning and operation. Charging proposals to support the introduction of this product have been considered in charging discussion paper NTS GCD 01 and will be further considered in charging consultation paper NTS GCM 05;

- **“NTS Exit (Flexibility) Capacity”** - to provide Users the ability to obtain rights to offtake gas in aggregate over a Gas Day at one or more NTS Exit Points within an NTS Exit Zone (to be defined in the enduring ExCR Methodology Statement) at flow rates which deviate from the even flow rate conferred through holding NTS Exit (Flat) Capacity. Actual utilisation of NTS Exit (Flexibility) Capacity for each User at each NTS Exit Zone on each Gas Day will be determined by subtracting 2/3 of its total end of day allocated quantity from the cumulative allocated quantity it has offtaken between 06:00 and 22:00, including a tolerance of 1.5%¹ on measurements of the cumulative flow. This in effect extends the current NTS Offtake (Flexibility) Capacity available to DNO Users at NTS/LDZ Offtakes to all Users and all NTS Exit Points within NTS Exit Zones. Such a product is anticipated to allow Users to compete, on a non-discriminatory basis, for constrained amounts of within day system capability that National Grid NTS will make available in accordance with its Licence obligations and incentives. In addition, this product, in the context of the proposed regime, will allow National Grid NTS to better manage the system, particularly in the context for large and/or unexpected within day flow rate variations.

Release of NTS Exit (Flexibility) Capacity

- 3.3 Both Shippers and DNO Users will be required to book and pay for NTS Exit (Flexibility) Capacity to avoid potential overrun charges. Users are able to book NTS Exit (Flexibility) Capacity:
- as an annual bundle of daily rights via annual “pay-as-bid” auctions in July of Gas Year Y for Gas Years Y+1 to Y+5 (inclusive). The quantities of capacity to be made available in each NTS Exit Area, NTS Exit Zone and for the NTS as a whole will be stated within the NTS Exit Capacity Release Methodology Statement; and
 - as a daily right via submission of Individual Offtake Profile Notices (OPNs) or if required by National Grid NTS, daily capacity “pay-as-bid” auctions.
- 3.4 Where auctions are used to release NTS Exit (Flexibility) Capacity, reserve prices are set by National Grid NTS representing the minimum price that Users can make in their auction bids. In the event daily auctions are not required and daily rights are released by the acceptance of OPNs, then the User will pay for any additional NTS Exit (Flexibility) Capacity obtained through this process at the reserve price used for daily auctions.

4 Terms of the Original Proposal

National Grid NTS proposed the following change to its Charging Methodology:

- a zero reserve price will be applied for NTS Exit (Flexibility) Capacity at all NTS Exit Zones for the annual and daily auctions.

This proposal would also result in the price of NTS Exit (Flexibility) Capacity obtained through the daily Offtake Profile Notice process, (i.e. where daily auctions are not required) as introduced under 0116V, being zero.

¹ It should be noted that UNC Modification Proposals 0116BV and 0116VD propose that this tolerance is increased to 3%.

5 Responses

Support for the Proposal

Industry Body	Respondent	Short Code	View
Shipper	E. ON UK plc	EON	Support zero reserve price
Shipper	Statoil (U.K.) Limited	STUK	Support zero reserve price
Shipper	Scottish & Southern Energy	SSE	Support zero reserve price
Shipper	EDF Energy	EDF	Unable to support
Transporter	Scotia Gas Networks	SGN	Support zero reserve price
Transporter	National Grid Distribution	NGD	Support zero reserve price

Summary of Responses

Respondents' Views

- 5.1 National Grid NTS received six responses to the charging methodology proposal NTS GCM04. All respondents except EDF expressed support for the charging proposal of zero reserve price for both annual and daily auctions of NTS Exit Flexibility Capacity. EDF supported the principle but was concerned about impacts of implementation. Four respondents (EON, STUK, SSE and NGD) stated this should not be taken as support of NTS Exit Reform proposals, with EON, SSE, and EDF providing some arguments against aspects or concepts of UNC proposed NTS Exit (Flexibility) Capacity. Copies of the responses have been posted on National Grid's web site.²
- 5.2 Four respondents (EON, SSE, EDF and SGN) observed that zero reserve price was consistent with the position of no NTS incremental investment to provide flexibility capacity and that flexibility was a by product of investment for NTS Exit (Flat) Capacity. SGN believed zero reserve price "would be reflective of actual costs incurred", and "would avoid any cross subsidy and encourage efficient use of capacity that is available".
- 5.3 SGN did not believe it would be appropriate to have locational variation in reserve prices.
- 5.4 EON and SGN remarked that it would have been helpful to have the referenced Exit Capacity Release Methodology Statement available during consultations such as this.

² <http://www.nationalgrid.com/uk/Gas/Charges/consultations/>

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- 5.5 Two respondents (STUK and SGN) made observations about National Grid's summary of NTS Exit Charging Discussion papers (Appendix A of the GCM04 Consultation). STUK agreed with "the sentiment that a flexibility commodity charge may not be required" and SGN awaited clarity about any revenue recovered from the release of annual or daily NTS Exit (Flexibility) Capacity.
 - 5.6 STUK suggested that consideration be given to delaying implementation to ensure consistency in implementation of DN interruption reform and lead time to assess flexibility requirements and to implement systems.
 - 5.7 The concerns expressed by EDF which made it unable to support were; the complexity of an auction process for flexibility in the UK transmission market, and the lack of incentive for investment in flexibility that might be needed for European transmission interoperability.

National Grid NTS's Response

- 5.8 National grid NTS welcomes respondents' support for this proposal and continues to believe that a zero reserve price for annual auctions is appropriate given that Flexible capacity is a by-product of investing for flat capacity and hence the availability of flexible capacity has been achieved at zero capital cost. A daily flexible capacity reserve price of zero is also consistent with flexibility capacity released at the day-ahead stage through the OPN process being at zero cost and is also consistent with a zero reserve price for annual flexible capacity.
- 5.9 National Grid NTS does not currently envisage locational variation of reserve price would be needed and therefore none is included in this proposal, however this matter must be kept under review.
- 5.10 Whilst National Grid NTS recognises that ideally an update on the Exit Capacity Release Methodology Statement was desirable for this consultation there have been no material changes that affect the proposal for zero reserve prices for the flexibility product.
- 5.11 Similarly there is little expectation of substantial revenues arising from NTS Exit (Flexibility) Capacity auctions and so National Grid NTS believes the summary of discussion consultations (contained in Appendix A of the GCM04 Consultation) was adequate for assessing the matter of zero reserve prices.
- 5.12 The timing of implementation of these charging proposals is aligned to implementation of UNC Proposal 0116V and is now known to fall in 2008, the same year as implementation of DN interruption reform.
- 5.13 The principles and design of NTS Exit Reform, including the Exit flexibility product and processes, has been the subject of extensive consultation that has fed into the decision that has been made by the Authority.
- 5.14 The Authority is now invited to consider, as an element that arises from its decision on NTS Exit Reform, this specific change to the National Grid NTS Gas Transmission Transportation Charging Methodology.

6 Changes to the Original Proposal in Light of Representations Made

- 6.1 Having considered the respondents' views, and taking into account the points put forward, National Grid NTS remains of the view that the introduction of zero Reserve Prices for NTS Exit (Flexibility) Capacity would better facilitate its GT licence objectives (as set out in section 4 of the Pricing Consultation Paper NTS GCM 04). Thus National Grid NTS has made no changes to the Original Proposal
- 6.2 Specifically National Grid NTS' proposals are as follows:
- a zero reserve price will be applied for NTS Exit (Flexibility) Capacity at all NTS Exit Zones for the annual and daily auctions.
- 6.3 This proposal would also result in the price of NTS Exit (Flexibility) Capacity obtained through the daily Offtake Profile Notice process, (i.e. where daily auctions are not required) as proposed under 0116V, being zero.

7 Assessment against the Relevant Objectives

- 7.1 This section presents National Grid NTS's views in respect of the extent to which the final proposal set out under section 4 would achieve the relevant methodology objectives under National Grid NTS's GT Licence and the EU Gas Regulations.

Assessment against Licence Objectives

- 7.2 The National Grid plc Gas Transporter Licence in respect of the NTS requires that proposed changes to the Charging Methodology shall achieve the relevant methodology objectives.

In so far as prices in respect of transportation arrangements are established by auction, either:

(i) no reserve price is applied, or

(ii) that reserve price is set at a level -

(I) best calculated to promote efficiency and avoid undue preference in the supply of transportation services; and

(II) best calculated to promote competition between gas suppliers and between gas shippers;

- 7.3 National Grid NTS believes that the proposals contained in this paper would satisfy the relevant objectives as no reserve price would be applied.
- 7.4 The proposed allocation process for NTS Exit (Flexibility) Capacity requires that all User bids are ranked in price order, regardless of their zone. Bids are then allocated in price order subject to national, area and zonal limits. This allocation process therefore prevents, to an extent, Users in zones with fewer Users having access to potentially cheaper Exit (Flexibility) Capacity than Users in zones with a larger number of Users.
- 7.5 This feature of the allocation process prevents, to an extent, Users in zones with fewer Users having access to potentially cheaper NTS Exit (Flexibility) Capacity than Users in zones with a larger number of Users. This process improves market liquidity, thus the use of a zero annual reserve price is considered appropriate, and ensures an efficient auction process.

Assessment against EU Gas Regulations

7.6 EC Regulation 1775/2005 on conditions for access to the natural gas transmission networks (binding from 1 July 2006) states that the principles for network access tariffs or the methodologies used to calculate them shall:

- Be transparent
- Take into account the need for system integrity and its improvement
- Reflect actual costs incurred for an efficient and structurally comparable network operator
- Be applied in a non-discriminatory manner
- Facilitate efficient gas trade and competition
- Avoid cross-subsidies between network users
- Provide incentives for investment and maintaining or creating interoperability for transmission networks
- Not restrict market liquidity
- Not distort trade across borders of different transmission systems.

7.7 National Grid NTS believes that its charging proposal put forward in this paper is consistent with the principles listed above in that they would not be expected to lead to market distortion by discouraging the use of NTS flexibility and the charge would be applied consistently across all NTS exit points. The reserve price would also reflect the costs incurred by the network operator recognising that NTS flexibility has been generated as a by product of NTS Exit (Flat) Capacity.

8 Timetable for Implementation

It is proposed that these arrangements are implemented to set NTS TO Exit (Flexibility) Capacity Reserve Prices from July 2008 in relation to NTS Exit (Flexibility) Capacity released for use from 1st October 2011.

Appendix A: National Grid NTS Exit Charging Discussion Papers

National Grid NTS has already consulted on NTS Exit (Flexibility) Capacity pricing arrangements through pricing discussion paper NTS GCD 02 published on 20th October 2006 with the consultation period ending on 24th November 2006. The consultation covered:

- the setting of reserve prices for both annual and daily auctions of NTS Exit (Flexibility) Capacity;
- a methodology for setting an NTS Exit (Flexibility) Commodity Rate.

Respondents were supportive of the setting of a zero reserve price for annual and daily NTS Exit (Flexibility) Capacity.

Respondents were not supportive of the methodology for setting an NTS SO Exit (Flexibility) Commodity charge. National Grid NTS continues to believe that there is potential for a change in behaviour in regard to the use of NTS flexibility if this flexibility is based only on the release of NTS Exit (Flexibility) Capacity and no commodity charge is levied. While there is flexibility within the NTS consistent with the release of the NTS Exit (Flexibility) Capacity product, the minimisation of the use of such capacity is consistent with the design principles of the NTS. The NTS was designed for the potential pressure variations associated with the flexible capacity product but was not designed for high frequency usage of this product.

National Grid NTS identified within the consultation paper the option to not introduce an NTS Exit (Flexibility) Commodity Charge immediately. If behaviours changed significantly, from that experienced to date National Grid NTS would commit to introduce an appropriately priced Flexibility Commodity Charge in the future. Conversely, if no change in behaviour materialised then a flexibility commodity charge may not be required.

National Grid NTS highlighted the difficulties associated with attributing exact costs to the use of NTS flexibility although it remains of the view that SO costs are linked to flexibility usage. Given that any NTS Exit (Flexibility) Commodity charge would not be implemented until October 2010 at the earliest, National Grid NTS proposes that further consideration of such a charge be facilitated through the industry review processes, such as the Gas TCMF, including alternative approaches to incentivising the appropriate usage of NTS flexibility.

Revenue Recovery

Gas Charging Discussion Paper NTS GCD01 "Introduction of NTS Exit (Flat) Capacity Charges under the enduring offtake arrangements", issued 20th October 2006, set out for discussion National Grid NTS' proposed options for amending the Charging Methodology in respect of the setting of NTS Exit (Flat) Capacity Prices from 1st October 2010.

Respondents were supportive of the approach set out in NTS GCD 01 subject to the adjustment of NTS Exit (Flat) Capacity charges and reserve prices to aim to recover the total TO Exit Capacity target allowed revenue through flat capacity charges. National Grid NTS recognises the benefits of such an approach and believe that it can be achieved provided that any revenue from the release of NTS Exit (Flexibility) Capacity is recycled through a negative TO Commodity charge.

Gas Charging Discussion Paper NTS GCD03 “Recovery of TO Allowable Revenue from Exit Users from 1st October 2010”, issued 20th October 2006, set out for discussion National Grid NTS’s proposed options for revising the Charging Methodology in respect of the introduction of a new mechanism to ensure recovery of TO Allowable Revenue from Users at NTS Exit Points from 1st October 2010.

Respondents were supportive of the introduction of an NTS TO Exit (Flat) Commodity charge as an appropriate mechanism to ensure National Grid NTS can comply with its Licence revenue restriction obligations. Support was expressed for this charge to be negative to manage over recovery with the restriction that, when taking into account the SO Exit Commodity charge, the net NTS commodity charge should be collared at zero.

Support for the TO Exit Commodity charge was subject to the adjustment of NTS Exit (Flat) Capacity charges and reserve prices to aim to recover the total TO Exit Capacity target allowed revenue through flat capacity charges. The TO Exit Commodity charge would therefore only be used of offset over-recovery arising due revenue relating to the sale of NTS Exit (Flexibility) Capacity.

National Grid NTS intends to consult on a proposal to introduce NTS Exit (Flat) Capacity Charges to aim to recover the total TO Exit Capacity target allowed revenue once a decision has been made on NTS GCM 01 “Alternative Methodologies for Determination of NTS Entry and Exit Capacity Prices”.

National Grid NTS intends to consult, if required, on a proposal to introduce NTS Exit (Flat) Commodity Charges once the Authority has made a determination on UNC Modification Proposal 0116V “Reform of the NTS Offtake Arrangements” and after the issues surrounding NTS Storage Commodity charging have been resolved.