

## **CONSULTATION DOCUMENT**

### **Modification Proposals to the Gas Transmission Transportation Charging Methodology**

#### **NTS GCM 04:**

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

**23<sup>rd</sup> February 2007**

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## 1 Executive Summary

This document sets out for consultation National Grid NTS's proposals for amending the Gas Transmission Transportation Charging Methodology (the "Charging Methodology") in respect of the introduction of Reserve Prices for the release of NTS Exit (Flexibility) Capacity. These Reserve Prices would be required in the event of implementation of UNC Modification 0116V ("Reform of the NTS Offtake arrangements") or alternates 0116BV or 0116VD, which would make available an NTS Exit (Flexibility) Capacity product to all Users as part of the enduring offtake arrangements. This product would be made available on a zonal basis with NTS Exit Zones as defined in the Exit Capacity Release Methodology Statement (ExCR).

In the event that UNC Modification Proposal 0116V, 0116BV or 0116VD is implemented, the first annual auctions for the release of NTS Exit (Flexibility) Capacity would be held in July 2007. National Grid NTS is undertaking this consultation ahead of Ofgem's decision on such Modification Proposals, anticipated late March 2007, to seek to allow publication of the Reserve Prices two months in advance of the auctions, were such auctions to be undertaken.

National Grid NTS published a pricing discussion paper NTS GCD 02 in October 2007 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 proposes through this consultation paper that:

- 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 proposed under 0116V, 0116BV and 0116VD, being zero.

National Grid NTS will only submit final proposals to the Authority to amend the Charging Methodology as a result of this consultation process in the event that UNC Modification Proposal 0116V, 0116BV or 0116VD is implemented.

## 2 Introduction

- 2.1 National Grid NTS has proposed UNC Modification Proposal 0116V “Reform of the NTS Offtake Arrangements” in respect of the release of Exit Capacity for utilisation from 1 October 2010. In the event that this proposal, or one of alternates 0116BV or 0116VD, is implemented, National Grid NTS would make available a capacity product referred to in the proposal as “NTS Exit (Flexibility) Capacity”.
- 2.2 In light of the potential 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 This consultation is being initiated at this time such that final proposals can be sent to the Authority, in light of responses received, after a decision has been made on UNC Modification Proposal 0116V and the alternates which is anticipated late March 2007. This is to seek sufficient time to publish prices two months ahead of the proposed first annual NTS Exit (Flexibility) Capacity auction in July 2007, were such auctions to be undertaken.
- 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 is progressing this option through this formal charging methodology consultation. 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 are discussed in a related consultation paper NTS GCM 05, “Introduction of NTS Exit (Flat) Capacity Charges under the enduring offtake arrangements”.

## 3 Background

- 3.1 UNC Modification Proposals 0116V, 0116BV and 0116VD “Reform of the NTS Offtake Arrangements” propose that common exit capacity products and registration processes are made available to all Users under the enduring offtake arrangements, commencing operation from 1 October 2010. 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 proposed 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%<sup>1</sup> 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 It is proposed that both Shippers and DNO Users will require 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 (IOPNs) 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 IOPNs, then the User will pay for any additional NTS Exit (Flexibility) Capacity obtained through this process at the reserve price used for daily auctions.

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

## 4 National Grid NTS's Proposal

- 4.1 When considering the setting of the reserve prices for NTS Exit (Flexibility) Capacity, the relevant licence objectives must be applied i.e. where prices are established by auction, the reserve prices should be set at levels best calculated to promote efficiency and avoid undue preference in the supply of transportation services and promote competition.
- 4.2 Prior to Network Sales, investments in the NTS had been undertaken based on the outcome of the integrated planning process across both the NTS and DNs. This considered the diurnal storage requirements of the DNs and whether this could be better provided from the NTS. Typically, such diurnal requirements could be provided as a result of NTS investments for end of day requirements.
- 4.3 It is also assumed moving forward that it is more efficient and economic for DNs to invest on their own networks for such diurnal requirements. Users will therefore not be able to bid for NTS Exit (Flexibility) Capacity above existing NTS capability levels in the annual auctions and thereby trigger investment specifically to release additional NTS Exit (Flexibility) Capacity.
- 4.4 On the basis that investments have historically been for end of day requirements, and that this will continue into the future, National Grid NTS considers that NTS investment costs should be related to NTS Exit (Flat) Capacity charges only. This therefore suggests a zero reserve price for annual auctions of NTS Exit (Flexibility) Capacity, unless there are grounds for setting higher levels for any NTS Exit Zone to overcome any concerns regarding lack of competition.
- 4.5 To ensure allocation of NTS Exit (Flexibility) Capacity levels consistent with the physical capability of the system, National Grid NTS will allocate capacity subject to national, area and zonal limits (as specified in the Exit Capacity Release Methodology Statement). The proposed allocation process 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. A zero annual reserve price is therefore considered appropriate.
- 4.6 National Grid NTS proposes that:
  - a zero reserve price will be applied for NTS Exit (Flexibility) Capacity at all NTS Exit Zones for the annual and daily auctions.

### Implementation

- 4.7 It is proposed that these arrangements are implemented to set NTS TO Exit (Flexibility) Capacity Reserve Prices from July 2007 in relation to NTS Exit (Flexibility) Capacity released for use from 1st October 2010.
- 4.8 For the avoidance of doubt, in the event that the setting of an NTS Exit (Flexibility) Capacity reserve price is not required due to the Ofgem's decisions on the various UNC Modification Proposals regarding the NTS offtake arrangements, National Grid NTS will not make a final proposal to change the Charging Methodology as a result of this consultation process.

## 5 Justification

### Assessment against Licence Objectives

5.1 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;*

5.2 National Grid NTS believes that the proposals contained in this paper would satisfy the relevant objectives as no reserve price would be applied.

5.3 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.

5.4 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

5.5 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.

- 5.6 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.

## 6 Questions for Consultation

- 6.1 National Grid NTS invites views on whether the proposed changes to our Gas Transmission Transportation Charging Methodology meet National Grid Gas's relevant GT Licence objectives, specifically that:
- a zero reserve price for all NTS Exit Zones is introduced for the annual auction of NTS Exit (Flexibility) Capacity, the first of which is proposed under Modification 0116V to be held in July 2007;
  - the reserve price for daily NTS Exit (Flexibility) Capacity would be the same as the reserve price for annual Exit (Flexibility) Capacity, with the first daily auctions proposed under Modification 0116V to be held in October 2010
- 6.2 National Grid NTS recognises the uncertainty in respect of the potential future NTS offtake arrangements and, in particular, industry concerns in respect of the introduction of the NTS Exit (Flexibility) Capacity product, however views to this consultation are sought now to ensure timely implementation of enduring arrangements is possible, in the event that annual flexibility auctions are to be undertaken in July 2007. National Grid NTS would encourage respondents to focus on whether this charging proposal meets the relevant charging objectives under National Grid NTS' GT Licence, rather than whether such a flexibility product is required.

The closing date for submission of your responses is **Friday 23<sup>rd</sup> March 2007**.

Your response should be e-mailed to [jan.gascoigne@uk.ngrid.com](mailto:jan.gascoigne@uk.ngrid.com) or alternatively by post to Jan Gascoigne, Regulatory Frameworks, National Grid, National Grid House, Gallows Hill, Warwick, CV34 6DA. If you wish to discuss any matter relating to this charge methodology consultation then please call Eddie Blackburn ☎ 01926 656022.

Responses to this consultation will be incorporated within National Grid NTS's conclusion report. If you wish your response to be treated as confidential then please mark it clearly to that effect.



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## 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 20<sup>th</sup> October 2006 with the consultation period ending on 24<sup>th</sup> 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 to offset over-recovery arising due to 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.