nationalgrid

Preliminary Consultation on Capacity Methodology Statements

Conclusions Report

12th April 2019

Executive Summary

Introduction

National Grid Gas plc's ("National Grid") Gas Transporter Licence in respect of the NTS ("the Licence") sets out obligations to develop and modify the:

- Entry Capacity Release Methodology Statement ("ECR"); and
- Exit Capacity Release Methodology Statement ("ExCR");
  together, the capacity release methodology statements defined in Special Condition 9B, and
- Entry Capacity Substitution Methodology Statement ("ECS");
- Exit Capacity Substitution Methodology Statement ("ExCS"); and
- Entry Capacity Transfer & Trade Methodology Statement ("ECTT");
  together, the Capacity Methodology Statements defined in Special Condition 9A.

We have been working closely with industry to develop the processes for the release of NTS Entry / Exit Capacity.

On the 16th January 2019 we invited all interested parties to comment on the potential revisions to the methodology statements through a preliminary consultation process. Thank you to all stakeholders who responded through this process, this has assisted us in developing our thinking.

Our updated proposals for the Methodology Statements are being released alongside this document and are being formally consulted upon, as required by the Licence.

This document sets out our conclusions on the preliminary consultation for the potential methodology statements. It provides a summary of the representations received, our response to those representations and an indication of whether, as a result of such representations, any changes will be made to the proposed statements which will be released for a formal consultation. The responses received were not marked as confidential and can be found on our web site at: https://www.nationalgridgas.com/capacity/capacity-methodology-statements.

Responses

Representations were received from three respondents listed below.

- Cadent Gas Ltd. CAD
- Wales and West Utilities WWU
- Energy UK EUK
- South Hook Gas Company Ltd. SHG

The main themes raised relate to:

- Frameworks: the balance of governance between the UNC and the methodology statements.
- The duration requirements for PARCA applications where the solution is funded incremental capacity.
- The withholding of daily NTS Exit Capacity for constraint management purposes.

Detailed comments from respondents and our responses are provided in the following table.

Cadent Gas Ltd (CAD) Response

Party	Reference	Response Quotes	NG NTS Response
CAD	Daily NTS Exit Capacity	Since the introduction of Exit Reform in 2012, Users have been encouraged to make use of the Daily Capacity products. Cadent has made significant investment in both People and Systems to ensure we procure a good balance of both Annual and Daily commercial product. Whilst we have no general issues over the addition of paragraphs 165 and 166, we would be concerned if the frequency with which National Grid called a capacity constraint were to increase, as in particular this would restrict our ability to make use of the Daily products.	We are making no changes to our underlying procedures regarding constraint management, and so envisage no increase in constraints called as a result of this addition. We shall always take action to try and prevent constraints on the system, and where a constraint is unavoidable then we shall seek to resolve it in the most cost effective manner in line with our obligations and incentives.
CAD	Daily NTS Exit Capacity	We would also like to ensure that a System Restriction Flexibility Notice (SFRN) is issued prior to the constraint being implemented. This would allow all affected Users to make the necessary adjustments to operational systems to ensure security of supply is maintained.	In line with the Short-Term Flexibility Restriction Notice (STFRN) methodology, an external STFRN should be sent to all offtakes in the NTS Exit Zone(s) if it is forecast that any of the OPN rule breaches may not be accepted.
CAD	Exit Capacity Substitution	Cadent is of the opinion that an inconsistency exists between the two scenarios where substitution is required as a result of an application for additional Enduring Annual NTS Exit (Flat) Capacity being made during the Annual Application Window compared to when entering into a PARCA. When done via a PARCA, a PARCA notice is issued enabling interested parties to determine if they need to secure capacity at their offtake by submitting a PARCA of their own. When the application is made during the Annual Application Window, given that no notice is issued, potential Donor parties are at a disadvantage as they are unaware of the risk of substitution at their offtakes. Cadent would like this apparent deficiency in the process to be addressed so that Users can be given the opportunity to respond to	We think there is some justification for this difference, in that the July window gives parties equal opportunity to acquire any unsold capacity, whereas PARCAs are a 'first come first serve' arrangement, and would otherwise have no 'competitive' element for acquiring capacity. If Cadent were to pursue this matter, then we would fully engage with any workgroup discussions.

		substitution at their offtake(s) under all circumstances.	
CAD	Exit Capacity Substitution	In addition, we understand that the application for Enduring Annual NTS Exit (Flat) Capacity made through the Ad-hoc application process would not be satisfied through substitution. If this were not to be the case, then we would expect that inconsistency to be addressed as well. The ability to respond to a substitution request is important to Cadent no matter what time in the year the application is made as we can potentially see a change in our demand profile at any time as a result of new or additional load requests.	In general then ad-hoc applications can indeed be satisfied via substitution. We have proposed to add in a new rule that will allow NG to consider 'interactive' ad-hoc applications received during a PARCA window. And for these 'interactive' ad-hoc applications only, then substitution is not possible, so as to not undermine the timeline for the PARCA.

Wales & West Utilities (WWU) Response

Party	Reference	Response Quotes	NG NTS Response
WWU	NPV test	In regard to entry capacity, we note that the Net Present Value test in the Entry Capacity Release Methodology Statement, which determines whether new National Transmission System entry capacity is constructed, permits construction of this capacity if the party requesting the connection signals that it will use 50% of the capacity requested. This implies that the other 50% is funded by other users of entry capacity. This arrangement for transmission entry capacity contrasts significantly with the arrangements in distribution despite the Gas Act not distinguishing between transmission and distribution. It seems that over time the interpretation has differed between transmission and distribution, albeit that the methodology statements and 4B statements have all been approved by Ofgem. The gas networks, both transmission and distribution, need to adapt to meet the challenges of decarbonisation.	We have no objection in principle to having a common methodology on certain topics where it makes sense to do so. We believe that any such move would need to be co-ordinated at a Licence level.

		We think that the principles underlying reinforcement policy in terms of how much is funded by the applicant and how much by the generality of customers should be consistent across transmission and distribution. This would mean that a producer of a new source of gas would see a consistent approach regardless of whether they were connecting to transmission or distribution networks.	
WWU	Governance	From our work on UNC modification proposal 0671 it is clear that there is a lot of detail in the methodology statements that has major impacts on Parties acquiring capacity, an example of this is the User Commitment obligation. These methodology statements are produced as a result of license obligations and therefore we accept that there is an argument that the license holder needs to have the ability to amend them as required. Nevertheless we think that there is a strong case for the key concepts to be under UNC governance because the purchase of capacity is fundamental to the commercial arrangements in the industry. The methodology statements acknowledge that where they are in conflict with the UNC then the UNC prevails meaning they are already indirectly subject to UNC influence. In addition we think that having the key principles under UNC governance will mean that Parties can access all the information relevant to acquiring capacity in one place. Currently they have to read UNC Transportation Principal Document section B on the Joint Office web site and also the relevant methodology statements on the National Grid web site. We think that the approach we propose would be in the spirit of the recently launched BEIS Energy Codes Review. A similar issue exists in respect of the NTS charging methodology; under the current UNC modification proposal 0678 the arrangements for determining the capacity for which Users will be charged will be in a methodology statement rather than being in the UNC itself. Given this tension between what is in the UNC and what is in methodology statements we suggest that National Grid should consider this question of the balance of governance in the near future. If this does not happen then UNC modifications may be	National Grid has an obligation to determine a methodology for capacity release and to relate this methodology in a statement. Nonetheless we have supported the development of some of the capacity rules within the UNC as this has generally been our customer's preference, and it facilitates industry led change. Where we have not supported rules going into the UNC is with regards to obligated quantities for release, including incremental, and with regards to user commitment which can lead to incremental capacity release. We appreciate your concerns around what the Licence/methodologies and UNC should govern, and we are happy to receive and discuss further suggestions on it.

		made over time which result in inconsistent approaches between the different processes which we think would be undesirable.	

Energy UK (EUK) Response

Party	Reference	Response Quotes	NG NTS Response
EUK	NPV test	This section again refers to issues that are anticipated but have not happened yet; the clearing obligation and economic test. We consider changes to the methodology statements should only occur once UNC and / or licence changes have happened or at the very least are being consulted upon in parallel.	The proposals we have put forward for the revised NPV test are 'all weather' with regards to whether LRMC, CWD or postage stamp is adopted. On that basis we believe it is appropriate to propose changes now as part of this methodology review to avoid a gap developing in the regime with regards to the NPV Test. For the clearing obligation then we have decided not to delete it from the methodology until such time as the Licence may change.
EUK	NPV test	Given that a UNC proposal 0667 has been raised with respect to the User Commitment at entry, we think that if National Grid suggests an alternative approach it should do so through an alternative to this proposal. This would help industry to consider the proposals in parallel, rather than have the current situation where the interactions between the two proposals are unclear.	We accept there will be uncertainty on the interaction between the UNC and the Methodology Statements if mod 667 were to be implemented, however a new alternative mod to 667 would not resolve that. Given that the current framework requires the determination of incremental quantities to be contained within a Methodology Statement, we believe that the appropriate approach is to put our proposals forward as a change to the methodology statement. Where a UNC modification proposes to change the commercial framework, then it is incumbent upon the proposer to make the case for change. If mod 667 were to be approved then we will consider what further changes to the methodology statement are required or desirable at the earliest opportunity, taking note of any related Licence change.
EUK	NPV test	We are not convinced that a duration requirement is needed in addition to meeting at least 50% of the estimated project costs and would like to understand the rationale for National Grid's view on this.	We have taken steps to explain our rationale further on this point - see slides presented to Transmission Workgroup on 07/03/19. We believe that user commitment requirements for new build incremental should not, in any cases, be a lower overall barrier than user commitment requirements for PARCA that are satisfied through non-incremental or substitution. This could make it more attractive for new supply to connect to constrained parts of the network.
EUK	Daily NTS Exit Capacity	National Grid raised the issue of not releasing daily capacity into a constraint a couple of years ago. We did not support it at that time nor do we now. It would be helpful if National Grid can explain what has changed since then so that the idea should be re-considered.	The issue was previously consulted on in a prior informal (i.e. preliminary) consultation in Jan 2014. After a concern was raised in one the responses, it was decided not to take it forward to the formal consultation at that time, due to the focus and volume of change associated with implementing PARCA

			in the ExCR at the time. However, the position of National Grid has always been that the change should happen.
EUK	Daily NTS Exit Capacity	National Grid should follow the rules in the UNC for the release of capacity at exit and entry, we do not believe it is appropriate that capacity release should be limited, by a methodology statement, in the event of a constraint as National Grid receives funding to manage such constraints. If National Grid wishes to pursue this change it should raise a UNC proposal so it can be fully considered.	We believe it is right to minimise the cost of constraints, and this should ultimately flow back to consumers. National Grid' capacity release obligation is determined by the Licence and therefore it is right that a Licence related document (i.e. ECR) manages this, so that compliance with the Licence is maintained.
EUK	Flow Diagrams	Energy UK considers that these should remain part of the ExCS, until similar or better information is available to help parties understand flows on the system, and the potential risks of capacity substitution.	Thank you for feedback. Will be retained for time being.
EUK	PARCA ad-hoc applications	Energy UK welcomes National Grid's proposal in response to stakeholder concerns, and agree that processing ad-hoc requests received during a PARCA window should provide for a similar outcome to the ad-hoc QSEC auctions at entry.	Thank you for feedback.

South Hook Gas Company Ltd. Response

Party	Reference	Response Quotes	NG NTS Response
SHG	NPV test	We are not supportive of the change to introduce a 16 quarter minimum requirement for all PARCA applications irrespective of whether a given application is met through (1) existing or substituted capacity or (2) incremental capacity. We feel that there are separate and distinct principles underpinning the user commitment tests for each of (1) and (2). The minimum 16 quarter duration for PARCA applications that are met through existing or substituted capacity is required to ensure that the applicant is not moving the capacity from one point to another on a regular basis. Crucially, the user commitment test for PARCAs met through existing or substituting capacity does not require the applicant to satisfy any financial test. The principles underpinning the user commitment test for incremental capacity (called the NPV or economic test) are entirely different. The NPV test associated with incremental capacity is	We believe that user commitment requirements for new build incremental should not, in any cases, be a lower overall barrier than user commitment requirements for PARCA that are satisfied through existing capacity or substitution. This could make it more attractive for new supply to connect to constrained parts of the network.

		intended to assure the financial commitment of the applicant. The PARCA applicant is required to contribute a defined financial amount towards the NTS investment costs associated with the incremental capacity3. This ensures that a proportion of investment costs incurred by NGG are recovered from the applicant, with the remainder share equitably in accordance with the underlying charging methodology . Applying the 16 quarter minimum requirement for incremental capacity does not create consistency between all of the user commitment tests. Rather, this would only make the test associated with incremental capacity more onerous for applicants and thereby potentially create a disincentive for investment.	
SHG	NPV test	More generally, we feel that the case for making the processes consistent in this respect has not been adequately made. We strongly believe that implementing any such amendment, given its potential economic impact on applicants, requires clear and objective supporting justification and analysis. In short, the solution must be proportionate, correctly targeted and result in an optimal outcome for the applicant and the wider industry.	We have taken steps to explain our rationale further on this point - please refer to our slides presented to Transmission Workgroup on 07/03/19.
SHG	NPV test	In reference to "prejudging" how the PARCA application is going to be concluded, NGG are required pursuant to its Transporter Licence (Special Condition 9A) to consider releasing substitution capacity prior to releasing Funded Incremental Obligated Entry Capacity. If a PARCA application can be met through existing unsold or substituting capacity, there is no need to progress with funded incremental capacity. The PARCA would then be subject to the Entry Capacity Substitution (ECS) Methodology. This is referenced in Paragraph 36 of the ECR Methodology where it states that "To minimise the need for investment, before releasing Funded Incremental Obligated Entry Capacity at an ASEP National Grid will consider opportunities to substitute unsold capacity from another ASEP. In addition, substitution will only be considered if the existing capability of the NTS is insufficient to satisfy requests for additional capacity at an ASEP". Therefore, there is an existing prescribed	We agree that we will always check the viability of substitution before considering the release of funded incremental capacity. Special Condition 9A requires that we ensure that Entry Capacity Substitution is effected in a manner which seeks to minimise the reasonably expected costs associated with Funded Incremental. We believe this is consistent with our view that it would be wrong in principle if the PARCA user commitment requirements for substitution could be higher than those for funded incremental. In practical terms we believe this could incentivise applicants to connect to constrained parts of the network resulting in uneconomic outcomes for consumers. Currently then only the Methodology Statements address rules for determining incremental release quantities. This seems appropriate given that the level of release quantity is set by the Licence and may affect

		decision making process that identifies how the capacity associated with the PARCA application is to be released. As a result of the above, we disagree that having a different minimum duration for the incremental process would drive inefficient and uneconomic investment in the NTS as the process ensures any substitution solution is identified prior to pursuing Funded Incremental Obligated Capacity. In fact, we believe that imposing an excessive minimum duration results in an uneconomic and inefficient NPV test as this results in users signalling more revenue than is required (please see analysis in Appendix 1). It is worth noting that other inconsistencies currently exist between the user commitment tests and that the preliminary consultation does not propose to resolve these other inconsistencies. For example, the user commitment test for incremental capacity met through substitution or existing capacity is within the UNC5 while the user commitment test for incremental capacity is exclusively set out in the Entry Capacity Release Methodology.	National Grid's allowed revenue.
SHG	NPV test	In addition, under the existing methodology, only the revenue associated with incremental capacity and any premium (on incremental or unsold baseline) contribute towards the NPV test. As a result of this, where an applicant does not have 16 quarters of incremental capacity signalled (but meets the requirement to signal incremental capacity, as discussed below), it is required to signal additional unsold capacity to meet the 16 quarter minimum requirement. This would always result in revenues being signalled in excess of those required under the NPV test, irrespective of the project cost used. It is counterintuitive that a mechanism designed to optimise the delivery of capacity could result in an outcome where a user is required to overbook capacity in order to fulfil incompatible investment hurdles. We are concerned that NGG may not be complying with its own Licence requirements to facilitate competition and non-discriminatory access to the network by requiring users to book capacity in excess of their requirements. Given that these additional bookings do not contribute towards the	The NPV test requires both capacity and financial commitment. We do not think it is unreasonable when building new infrastructure to see corresponding user commitment, up to the level of the additional capacity provided by the infrastructure, over a sustained period. We also do not accept that retaining minimised duration aspects (that are far less than the current test and are retained for good reason) could be described as failing to facilitate competition. Additionally, as a network, then we believe it is right that there is a comparative element to the test so that user commitment should not be a higher overall barrier for substitution compared to obligated incremental. As stated earlier this could result in a framework which develops the network in an inefficient manner. However, we recognise and understand the concerns raised by SHG, and would be willing to lower the required 16 quarter capacity commitment for

		financial commitment aspect of the NPV test, being only required to satisfy the minimum duration requirement, the imposition of the minimum duration requirement could lead to inefficiencies and uneconomic impacts being driven into the capacity booking system (as there may be no commercial rationale for a PARCA applicant to acquire this excess capacity other than to satisfy the NPV test). This requirement may have a significant impact on the financial modelling underpinning decision-making by potential and existing PARCA applicants, especially when combined with the expected changes to the Gas Transmission Charging Regime6 where capacity charges are proposed to have a floating reserve price and an unknown revenue recovery charge on all capacity holdings. This increases the amount of uncertainty and potential cost relating to acquiring incremental capacity and could disincentivise investment in GB.	incremental if it is first lowered for existing capacity and substitution. We have now proposed drafting in the ECR that would allow any change to the 16 quarter application rule for non-incremental capacity in the UNC to also feed through to the corresponding rules for substitution and incremental within the ECR.
SHG	NPV test	It is also worth noting that the prices generated from the Gas Transmission Charging Review are based on a cost allocation model and not marginal costs. Therefore, having a minimum duration requirement alongside a cost allocation model could result in different System Entry Points contributing different amounts of revenue which are unrelated to the project costs and seems discriminatory against certain Entry Points on the NTS7.	We do not agree that the introduction of a cost allocation model under the charging review prohibits the retention of capacity based rules pertaining to user commitment.
SHG	NPV test	As a result of the above, we do not support the introduction into the NPV test of a minimum duration element of 16 quarters on the grounds of alignment of the user commitment tests. We believe the requirement to signal incremental capacity over a minimum of 4 separate years provides the necessary assurance to NGG of the PARCA applicant's sustained requirement for incremental capacity. If an additional duration element is to be introduced into the NPV test then it should be expected, at a minimum, that all quarters contribute towards the NPV test.	We believe that whether or not capacity revenue contributes to the test must depend on whether existing unsold baseline or new incremental capacity has been acquired. The duration point is addressed above, and we would be willing to reduce the 16 quarter requirement if it is first reduced for existing capacity and substitution solutions.
SHG	NPV test	We recognise the need to move away from the current methodology used to derive the estimated project costs as the LRMC model is likely to no longer be used following implementation	We recognise that changing the methodology for the project cost can add considerable uncertainty to in-flight PARCAs regarding the costs they are exposed to. We have proposed a transition rule in the ECR to relieve parties

		of a Gas Transmission Charging Review modification. We note with some disappointment that, despite NGG having invited comments on the potential introduction of a legacy rule for inflight PARCAs, the preliminary consultation does not contain any intention of introducing such a legacy rule. To be clear, we support the establishment of a legacy rule for inflight PARCAs. In addition, it is concerning that the proposed adoption of the Generic Revenue Driver Methodology (GRDM) to calculate the project cost does not align with the current PARCA process. Our principal concern here is that any inflight PARCA8 would be subject to an unknown cost, as a preferred build option and the subsequent project costs (using the proposed methodology) cannot be provided until at least 12 months into PARCA Phase 2. The PARCA process should provide certainty for both the applicant and NGG, allowing both parties to develop their associated projects in parallel. However, this proposed change would result in a significant amount of financial uncertainty and, by extension, project completion risk for any current or future applicant. For the proposed project cost calculation methodology to be implemented appropriately the PARCA process should be amended to allow for the preferred build option to be presented, along with the estimated costs, at the end of Phase 1. In addition, there needs to be greater granularity in the report to allow the parties to identify which works forming part of the preferred build option are necessary for the release of incremental capacity. This will provide the necessary assurance to the applicant that the proposed project costs are to be incurred in respect of the works required to achieve the ultimate objective of the PARCA application and investment decision.	of this uncertainty.
SHG	NPV test	We support the introduction of a capacity price premium which is payable in addition to the reserve price to allow the NPV test to be passed. It is generally accepted that, in contrast to the situation when the current NPV test was first implemented, most NTS users are now no longer booking long term capacity. Therefore, it has become increasingly difficult to pass the NPV test. The concept of a	Thank you for your feedback.

		premium is already used within the NPV test for incremental capacity at interconnection points9 and therefore we would support the proposal to follow the same approach for domestic incremental capacity release.	
SHG	NPV test	While we are generally not supportive of a minimum duration within the NPV test associated with incremental capacity (for the reasons set out in point 1 above) we understand NGG's concerns that using a premium without any minimum duration could result in a scenario where incremental capacity is released uneconomically. As such, we would consider that the introduction of a requirement to signal incremental capacity over a minimum of 4 separate years represents a pragmatic compromise. We believe this is a suitable minimum duration as it ensures there is a sustained commitment for incremental capacity, in contrast to the excessive commitment under the 16 quarter minimum duration as proposed in the preliminary consultation.	Thank you for your feedback.
SHG	PARCA – clarity of process	As a general point, we would expect the Entry Capacity Release (ECR) Methodology to provide clarity and certainty for PARCA applicants in order to create a stable and transparent basis for investment in GB infrastructure projects. However, our experience in our application is that the processes and requirements as contained in the current Entry Capacity Release Methodology statement have fallen short in this regard. In response to this a UNC Modification2 has been raised by South Hook Gas to insert the Entry Incremental Capacity NPV test into the UNC.	We agree there is scope to improve clarity within the ECR and would value SHG's input in this regard.