

To all interested parties,

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National Grid Gas's Preliminary Consultation on Capacity Methodologies and Statements

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 the

- Entry Capacity Substitution Methodology Statement ("ECS");
- Exit Capacity Substitution and Revision Methodology Statement ("ExCS"); and
- Entry Capacity Transfer and Trade Methodology Statements ("ECTT");

together, the 'Capacity Methodology Statements' defined in Special Condition 9A.

As part of the review process for these statements, we are consulting with interested parties on the proposed changes. Due to the extent of the potential revisions regarding the economic test, we believe that a preliminary consultation would be beneficial for industry, both to understand the extent and impact of, and to have an opportunity to provide feedback on these proposed changes. This will also assist us in the further development of the statements, if required.

Additionally then because there is considerable change proposed to the ECR and ExCR, and because there is considerable change happening elsewhere in the industry, then no material changes are proposed to the ECS, ExCS and ECTT at this time. We note that Ofgem have recently released sector specific consultations as part of their RIIO-2 engagement, and as part of the consultation for Gas Transmission then they have asked us to look at 'arrangements for accessing unsold capacity'. This naturally captures the processes contained within ECS, ExCS and ECTT and we will therefore be reviewing these processes further as part of that process. Having said that, we would like to take the opportunity to specifically check if stakeholders still value the flow diagrams in annex 1 of the ExCS. However overall, our main focus for this consultation is on understanding stakeholder views on the proposed changes to ECR and ExCR.

This letter identifies the proposed changes, and the reasons for them. Due to the extent of the change to the economic test then further details have been included in a separate appendix: see appendix I.

Drivers for change

Relevant UNC modifications that have been implemented

We have been working closely with industry to develop new processes under the following UNC Modifications:

- 0616s: "Capacity Conversion Mechanism for Interconnection Points";
- 0628s: "Standard Design Connections: PARCA process";

These changes have been implemented in the UNC, and for completeness should also be reflected in the ECR and ExCR.

We also note that Ofgem may introduce a more streamlined process for adding points to the Licence, in accordance with the Customer Low Cost Connections (CLoCC) ambition to connect customers to the NTS faster, and so some minor wording changes have been made to the ECR and ExCR to prepare for this.

EU Network Code on Tariffs (TAR code) & the GB Charging Review

It is anticipated that any new charging methodology will no longer be based on the Long Run Marginal Cost (LRMC) approach. If no changes were to be made to the economic test then the test would become inoperable. A revised test has been proposed that uses some key concepts from the economic test prescribed within the EU Codes. Note: the revised test proposed here is not dependent on any particular outcome of the charging review, and so can be considered as 'all weather' with regards to whatever charging methodology is put in place.

It is also anticipated that there will be the removal of zero reserve price for within day auctions as a result of implementation of the TAR code. It is therefore proposed to remove the reference to the clearing allocation in the ECR as part of this review. Note: this by itself will not change whether or not we have a clearing obligation as that sits in the Licence. It is only a reference to the obligation that would be removed.

Ofgem RIIO Consultation

It would be impractical to fully address all the points raised in the consultation here, but there is one point worth highlighting. While discussing access arrangements to the NTS, Ofgem queries: 'The need for an economic test for capacity demands that can be met wholly from substitution.' It should be noted that the revised test proposed by us as part of this review achieves this outcome.

Planning and Advanced Reservation of Capacity Agreement (PARCA)

Stakeholders have queried whether ad-hoc applications received during a PARCA window should be processed, rather than sitting in a queue waiting for the PARCA to resolve. This would allow parties to respond to PARCAs on Exit, in a similar way to how the ad-hoc QSEC auction allows parties to respond to PARCAs on Entry.

Other changes

We believe it is not economic or efficient to continue to sell more capacity into a constraint, and therefore will consider withholding daily capacity from auctions in constraint scenarios. This rule is already contained within the ECR however it is not within the ExCR. For consistency and transparency then we propose to add this approach into the ExCR.

Relevant UNC modification proposals that are in development

Regarding any live modifications following the charging review then please refer to the earlier section on 'TAR code and GB Charging Review'.

Regarding UNC modification proposal 667¹, then we have been engaging with industry and listening to concerns raised regarding the economic test. This feedback has helped shape the proposals we have put forward, as part of this review.

Regarding UNC modification proposal 671², we note there may be some impact on user commitment here, and an alternative route for acquiring capacity at a particular point. Once this modification has completed development then we will establish what changes are required to the statements, and propose further revisions accordingly.

Changes

The main changes that have been made to the statements are detailed below, and where practical then relevant (new, unless otherwise stated) paragraphs have been identified in square brackets:

- Entry Capacity Release Methodology Statement:
 - The reference to the obligation for a clearing allocation is removed. [52, 180]
 - The 16 quarter minimum requirement for PARCAs now incorporates all PARCA applications, without prejudging whether that PARCA is met through existing, substituted or incremental capacity. [54]
 - The section on PARCA has been amended to include the new additions from UNC modification 628s, notably the concept of a 'capacity indicator'. [92, 94, 99]

¹ A proposal for 'Inclusion and Amendment of Entry Incremental Capacity Release NPV test in UNC'.

² A proposal for a 'New Capacity Exchange process at NTS exit points for capacity below baseline'.

- Chapter 6 has been amended to recognise: a new way to determine the project cost used in the Economic Test; a new way to determine the capacity price premium for PARCA projects requiring incremental capacity; a rule to determine the amount of incremental capacity signalled; and various corresponding clarifications to how the new proposed Economic Test would work.[Chapter 6 , Chapter 7]
- The inclusion of the amount of capacity released through Capacity Conversion (Interconnection Points only). [190 – 194, 237]
- Exit Capacity Release Methodology Statement:
 - Process ad-hoc applications received during the PARCA window. [106]
 - The section on PARCA has been amended to include the new additions from UNC modification 628s, notably the concept of a ‘capacity indicator’. [72, 74, 82]
 - Legacy references to ARCA are removed. [Old references: 132, 133, 135, 137, 141]
 - Text has been added explaining that we may withhold daily capacity from sale in the event of a constraint. [165, 166, 202, 203]
 - The inclusion of the amount of capacity released through Capacity Conversion (Interconnection Points only). [196 – 200, 244]
- All Statements:
 - Housekeeping updates to weblinks and dates.
 - Technical clarifications.

To assist in reviewing the proposed changes to the capacity statements the following documents are available on our website <https://www.nationalgridgas.com/capacity/capacity-methodology-statements>. In each case please scroll down to the sections headed “Current Review and Consultation”.

Entry Capacity Release (ECR): a clean version 4.1 and a track change from version 4.0
 Exit Capacity Release (ExCR): a clean version 12.1 and a track change from version 12.0
 Entry Capacity Substitution (ECS): a clean version 9.1 and a track change to version 9.0
 Exit Capacity Substitution & Revision (ExCS): a clean version 7.1 and a track change to version 7.0
 Entry Capacity Trade and Transfer (ECTT): a clean version 9.1 and a track change to version 9.0

The current approved version of each statement can also be found on the relevant web page.

Please be aware that these statements are not necessarily our final proposals. They will be developed further in the light of responses received and additional developments in industry workshops prior to the formal consultation process (as required by the Licence), which is anticipated to take place in March/April 2019.

We would appreciate the comments of all interested parties on the draft changes to the capacity release statements and the capacity statements. We also invite comment on whether it is appropriate to introduce a legacy or transition rule for any aspect of the economic test e.g. project cost, for any in-flight³ PARCAs. Responses should arrive with us by 17:00 on Friday 15th February 2019 and be sent by e-mail to malcolm.montgomery@nationalgrid.com and copied to box.transmissioncapacityandcharging@nationalgrid.com

Alternatively they can be sent by post to the above address marked for the attention of: “Malcolm Montgomery”, Floor D2

Responses will be placed on our website and incorporated within the consultation conclusions report. If you wish your response to be treated as confidential then please mark it clearly to that effect.

Yours sincerely

Chris Logue
 Market Change Delivery Manager

³ An in-flight PARCA is an entry PARCA that has already completed the 1st economic test (under the current rules) at the end of phase 1, but is yet to complete the 2nd economic test (under new rules, if approved) at the end of phase 2.

Appendix I – Further detail regarding the economic test

Summary of current test (Entry capacity, Non Interconnection Points)

The current test compares the incremental revenue against a project value for delivering the incremental capacity. As long as the incremental revenue \geq 50% of the project value then the test is passed. This ensures that the User has demonstrated sufficient commitment to the project before National Grid invests in the network and makes sure there is no undue socialisation of the costs. The LRMC charging methodology is used to calculate the incremental cost of delivering the project (Project Value) and an associated price. This is done for up to 20 different incremental price steps to cover a range of differently sized projects.

Description of Changes

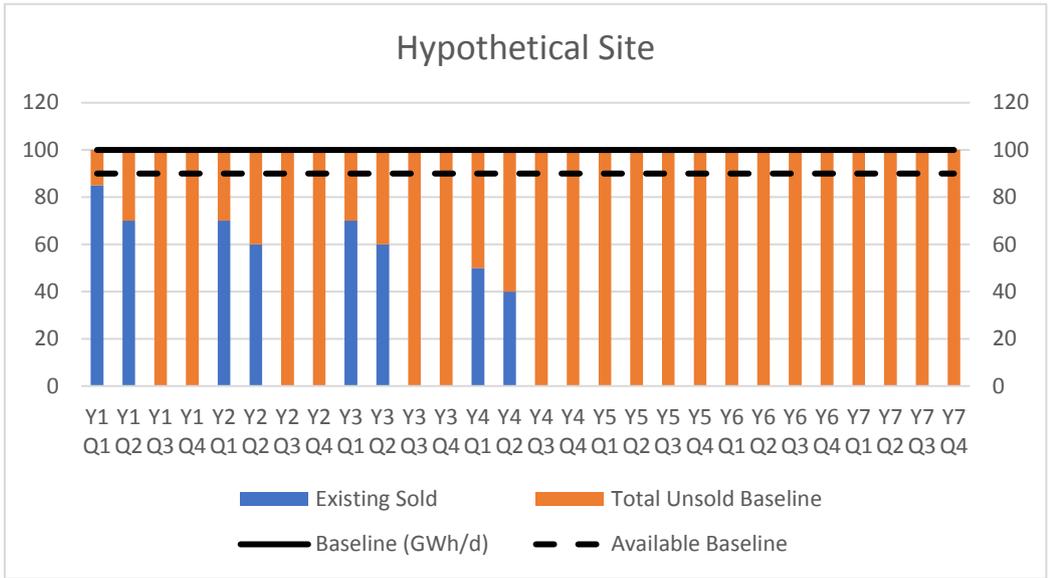
A new method for producing project costs that is not dependent upon LRMC is required. There is currently an established methodology for calculating project costs – this is the Generic Revenue Driver Methodology (GRDM) which was introduced at the start of RIIO T1. The GRDM is used to calculate the increase in allowed revenue for National Grid, and so is an accurate reflection of the cost to industry of funding the new investment. The economic test used in the EU network code on Capacity Allocation Mechanisms (CAM code) also requires the use of an ‘estimated increase in allowed revenue’, and so there is precedent in using this approach. It is proposed to adopt the revenue driver calculation as provided by the GRDM.

A new method for producing incremental pricing that is not dependent upon LRMC is required. While incremental price steps (P1 to P20) will continue to be produced for the QSEC auction, they will no longer have any link to the project costs, and therefore will not provide suitable or cost reflective pricing for the incremental project. We also recognise that the current pricing approach limits flexibility for how customers pass the economic test, and may not be conducive to new investment on the network if it forces customers to adopt a capacity profile that is perceived as inefficient or uneconomic. The CAM code test uses the concept of a ‘mandatory minimum premium’, which means that if the economic test cannot be passed at the reserve price, then a premium can be added to allow sufficient revenue to be generated. It is therefore proposed to replace the P1 to P20 price steps with a variable premium that can be set on a project specific basis to allow sufficient revenue to be generated.

Removing the price cap (currently P20) and replacing it with an uncapped premium means that potentially the test could now be passed in a single quarter at very high premium. We believe this would be inappropriate and that a sustained demand for the incremental capacity still needs to be demonstrated. A compromise approach has developed under modification proposal 667 where a commitment is still demonstrated over a minimum of 4 separate years, however it is not necessary to buy up every quarter within those 4 years. We are proposing the same arrangement. But please note that we have also maintained and extended the current 16 quarter minimum booking rule for PARCA applications.

Example scenarios are shown below.

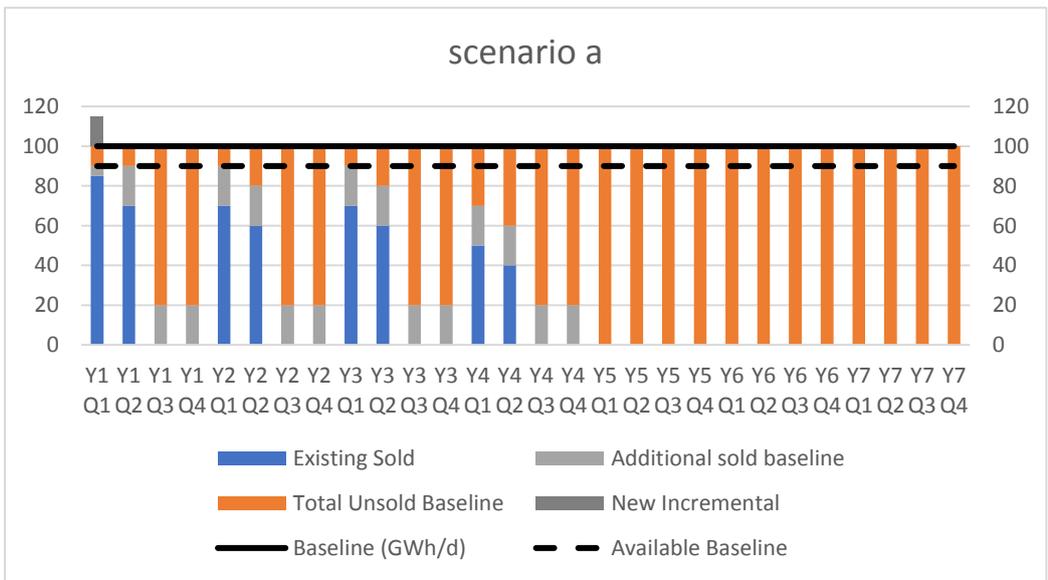
Example: An ASEP has a baseline of 100 and long term bookings as shown below.



A PARCA applicant wishes to book an additional 20 units for a new project.
 PARCA booking rule: the PARCA application must have a minimum of 20 units booked across at least 16 quarters out of 32 (from the first quarter booked).
 Incremental signal check: the incremental signal will be the highest common amount above baseline (in at least 1 quarter) over 4 separate gas years. This will be subject to a cap of the PARCA amount requested i.e. if the PARCA application is only requesting 20 units then it cannot trigger an incremental amount of > 20.

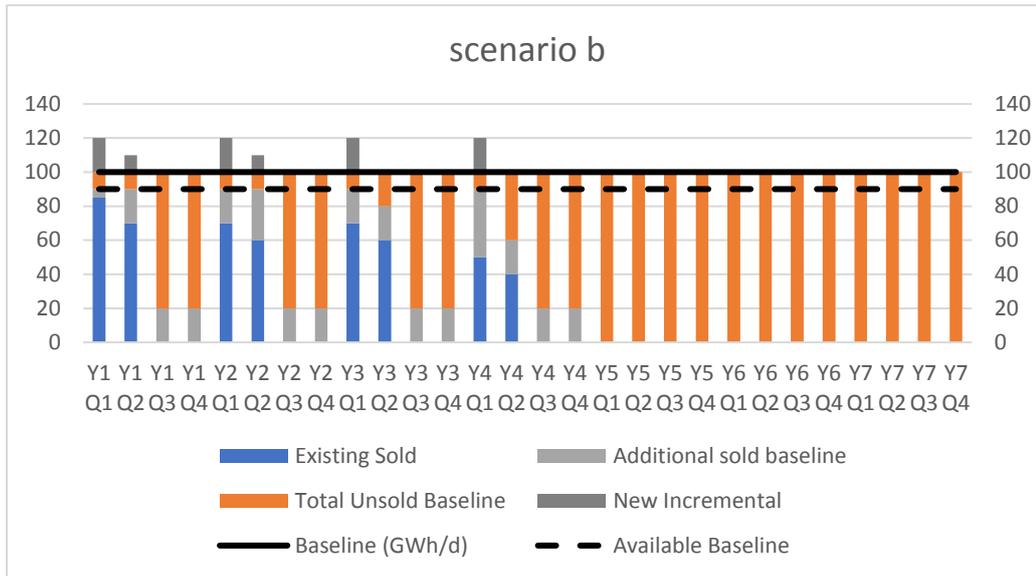
Consider the following scenarios:

- a) The PARCA applicant submits the following booking profile – a flat additional 20 units across the first 16 quarters.



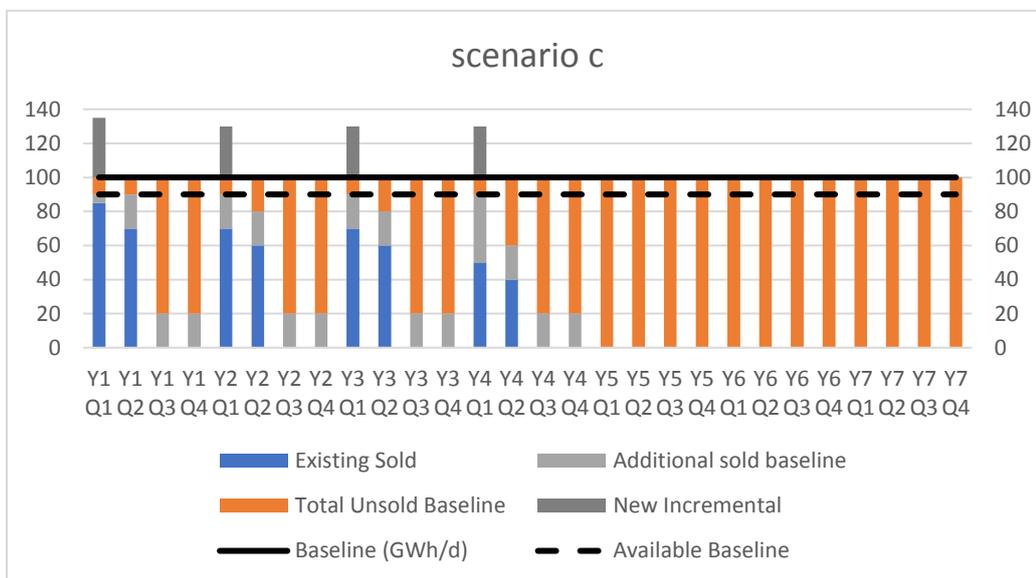
A incremental demand is signalled for 1 quarter (Y1Q1) for 15 units. This is not a sustained demand across 4 different gas years and so the incremental signal is 0.

- b) The PARCA applicant submits the following booking profile. 20 units booked in each of the first 16 quarters, plus additional capacity in Y1Q1, Y1Q2, Y2Q1, Y2Q2, Y3Q1 and Y4Q1.



There is a sustained incremental demand across 4 different gas years, and the highest common amount across the 4 years gives an incremental demand of 20 units. There is a signal to release 20 units of incremental capacity to the applicant.

- c) The PARCA applicant submits the following booking profile. 20 units booked in each of the first 16 quarters, plus additional capacity in Y1Q1, Y2Q1, Y3Q1 and Y4Q1.



There is sustained demand across 4 different gas years, and the highest common amount across the 4 years gives an incremental demand of 30 units. However the PARCA project is only for 20 units across the 16 quarters. A cap of 20 units will be applied on the incremental capacity considered for release. (To signal 30 units of incremental capacity the applicant would need to book a minimum of 30 units across the 16 quarters).