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Dear Chris,

**Decision on the Exit Capacity Release Methodology Statement ('ExCR') (Special Condition 9.18 of National Grid Gas plc ('NGG') Gas Transporter Licence<sup>1</sup> (the 'licence'))**

Thank you for submitting the proposed modifications to the ExCR to us<sup>2</sup> for approval on 29 April 2022.<sup>3</sup> The proposed revisions were submitted in your consultation report.<sup>4</sup>

We have decided to approve the proposed revisions to the ExCR and we have outlined our reasons for doing so in this letter.

**Revision of the ExCR in accordance with Special Condition 9.18.10 of the licence**

Special Condition 9.18.10 of your licence provides that you must, if so directed by the Authority, and in any event not less than once in every period of two regulatory years, review the ExCR. Additionally, in accordance with Special Condition 9.18.11(d) of the

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<sup>1</sup> The link to the National Grid Gas Plc ('NGG') Gas Transporter Licence is here: <https://epr.ofgem.gov.uk/Content/Documents/National%20Grid%20Gas%20Plc%20-%20Special%20Conditions%20Consolidated%20-%20Current%20Version.pdf>.

<sup>2</sup> The terms "the Authority", "Ofgem", "we", "us" and "our" are used interchangeably in this letter.

<sup>3</sup> This includes NGG's consultation report.

<sup>4</sup> The consultation with relevant stakeholders ran between 18 March and 15 April 2022, and two responses were received. The responses and the revisions proposed (pursuant to Special Condition 9.18.11(c)) are available at the following link: <https://www.nationalgrid.com/uk/gas-transmission/capacity/capacity-methodology-statements>.

licence, an examination has been carried out by an Independent Examiner<sup>5</sup> into whether the revised capacity release methodology statement is consistent with the licensee's duties under the licence and the Gas Act 1986, and a report expressing their opinion has been submitted to us.

### **NGG Consultation on revisions to the ExCR**

NGG proposed introducing the following changes to their ExCR:

- Reduction of the user commitment<sup>6</sup> for incremental capacity from 4 years to 2 years for instances where the additional capacity is made available via substitution as per Exit Capacity Substitution methodology statement.<sup>7</sup>
- Change to the price feeding into the calculation of the Planning and Advanced Reservation of Capacity Agreement (PARCA) User Commitment Amount.
- Relevant licence changes associated with implementation of Uniform Network Code (UNC) modification 0785<sup>8</sup> and removal of references to Enduring capacity at Interconnector Points (IPs) due to their expiry.
- Estimated Project Cost Analysis at Exit IPs.
- Changes related to assignment process as a result of implementation of UNC modification 0755S 'Enhancement of Exit Capacity Assignments'.<sup>9</sup>

### **Responses to NGG's consultation**

You submitted your consultation report to us on 29 April 2022. You received two responses, neither of which was marked as confidential. These are available on NGG's website.<sup>10</sup> One respondent was generally in support of the proposed changes to the ExCR, while the other disagreed with the changes relating to the methodology for estimating project costs at Exit IPs.

#### Reduction of the user commitment

One respondent expressed support for the reduction of user commitment from 4 to 2 years for incremental capacity where additional capacity is made available via substitution. The reason given was that this provides greater flexibility for users and the ability to reduce capacity holdings sooner, and releases capacity for others that would otherwise become sterilised. It was their view that this would benefit the customer through supporting more

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<sup>5</sup> An Independent Examiner means a person nominated by and independent of the licensee with the skills and knowledge to undertake an examination.

<sup>6</sup> User commitment is a financial commitment associated with capacity allocation and its calculation and applicability is described in the ExCR.

<sup>7</sup> Special Condition 9.17 of the Gas Transporter Licence requires that licensees maintain an Exit Capacity Substitution methodology statement.

<sup>8</sup> <https://www.gasgovernance.co.uk/0785>.

<sup>9</sup> <https://www.gasgovernance.co.uk/0755>.

<sup>10</sup> <https://www.nationalgrid.com/gas-transmission/capacity/capacity-methodology-statements>.

efficient use of the system. The Independent Examiner agreed with these points, and consequently were of the opinion that the proposed change to the text better reflects the duties and obligations placed on NGG.

Furthermore, the respondent also considered that in cases where no investment on the network is required then user commitment should not apply as in their view there is no justification for passing this on to the end consumer. Similarly, they responded that if a Gas Distribution Network (GDN) seeks to secure Enduring NTS Exit (Flat) Capacity in line with that published within the latest Exit Capacity Planning Guidance document<sup>11</sup> then there should be no user commitment. The argument put forward for this was that the requirements on GDNs introduced by the Exit Capacity Planning Guidance<sup>12</sup> are driven solely by the need to secure Peak Day capacity, so it might be the case that GDNs incurring user commitment is unnecessary and inefficient from a whole system perspective. The Independent Examiner also noted that their 2021 Report stated that removing the requirement for user commitment to apply to GDNs may provide additional benefits because of safeguards introduced by the Exit Capacity Planning Guidance.

#### Our views

We agree that in improving flexibility and availability of capacity for users, the proposed reduction of user commitment is consistent with NGG's obligation to operate an economic and efficient network and we approve this change to the ExCR. With regard to the suggested benefits of removing user commitment for GDNs in all circumstances, we informally consulted on this proposal<sup>13</sup> in May 2021, and have yet to publish our findings on this.

#### Change to the price feeding into the calculation of the PARCA User Commitment Amount

One respondent stated their support for NGG using the actual capacity price instead of the indicative capacity price, where the actual price is available, to feed into the calculation of the PARCA User Commitment Amount. The reason given was that in the instance of a PARCA, it will add clarity on the final User Commitment Amount. The Independent Examiner said that it agreed with the proposal on the basis that recent history has shown that in practice when user commitment amounts are calculated, actual capacity prices might be known, removing the need to use indicative prices in some cases. The Independent Examiner also stated that the proposed change appears to better reflect the intent of the duties and obligations on NGG.

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<sup>11</sup> As per Standard Special Condition A57: Exit Capacity Planning.

<sup>12</sup> <https://www.ofgem.gov.uk/publications/exit-capacity-planning-guidance>.

<sup>13</sup> <https://www.ofgem.gov.uk/publications/informal-consultation-removing-user-commitment-gas-distribution-networks-gdns-booking-exit-capacity-and-including-baseline>.

### Our views

We are also of the opinion that using the actual capacity price, where it is available, as opposed to the indicative price is advantageous in providing greater financial certainty for users, and agree that the proposed change should be implemented because it increases system efficiency in line with NGG's obligations.

### Relevant licence changes associated with implementation of UNC modification 0785 and removal of references to Enduring capacity at IPs due to their expiry

One respondent expressed support for the proposed minor changes to the ExCR as a result of UNC modification 0785 aggregating Bacton Exit IP and the removal of references to Enduring capacity at IPs given that they relate to previous regulatory decisions. The Independent Examiner agreed that these changes to remove text that is no longer relevant were sensible and so better reflected the intent of NGG's obligations and duties.

### Our views

In our view, the proposal to bring the ExCR in line with the licence changes made by UNC modification 0785, and the removal of references to Enduring capacity, are necessary to make the ExCR text accurate and up to date.

### Estimated Project Cost Analysis at Exit IPs

One respondent disagreed with the proposed addition of a new methodology to determine the cost of incremental capacity at IPs. It was their view that this is inconsistent with Article 6 of the EU Capacity Allocation Mechanism (CAM) Network Code<sup>14</sup> in the requirement for Transmission System Operators (TSOs) to apply a dynamic approach to calculating technical capacity at IPs and to give priority to those IPs where there is contractual congestion, in seeking to maximise the offer of capacity. They stated that given the NTS Exit Capacity at Bacton IP is contractually congested, NGG's proposed methodology should set out how the incremental capacity release analysis incorporates a 'dynamic' approach which 'prioritises' such IPs, and that the approach of rebalancing the NTS system at the "point of least interaction" is an overly cautious, restrictive and non-dynamic approach which will tend to over-state the reinforcement costs associated with any incremental capacity provision at an IP.

However, the Independent Examiner's opinion on the calculation methodology was that while there were risks associated with the proposed approach – including that the use of the least interactive entry point to rebalance supplies may overestimate project costs, but is conceptually necessary - these are immaterial given that it is unlikely that capacity will

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<sup>14</sup> <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32017R0459>.

be expanded across the interconnectors. They considered that NGG's proposal for the new methodology, whilst "flawed", was not inappropriate.

The potential flaws the Independent Examiner identified in the methodology included that the use of outturn costs of recent projects to provide unit costs into the estimation, of which NGG has not provided any detail, can be a source of contention during price control processes and it is possible that alternative unit cost assumptions would be more appropriate. Additionally, the Independent Examiner said that for the Moffat Exit IP, the calculation methodology proposed may lead to significant under- and over-estimates in project costs in some regions.

#### Our views

With respect to the assertion that the methodology conflicts with NGG's obligations under Article 6 of the EU CAM Network Code, we believe that Article 6 does not apply because it places obligations on TSOs to release the maximum technical capacity available, which means in this case that it applies only to baseline capacity and not to incremental capacity.

We approve NGG's proposal to change the methodology to determine the cost of incremental capacity at IPs on the basis that the methodology proposed is appropriate and proportionate for the purpose of estimating project costs at Exit IPs. In terms of the Independent Examiner's view that the methodology is flawed (despite agreeing that the change should be introduced), we accept that there is a risk of inaccuracy inherent in any calculation methodology for estimating project costs. We are satisfied that the proposed methodology provides an estimate that is adequate for the purpose for which it is required.

#### Changes related to assignment process as an outcome of implementation of UNC modification 0755S 'Enhancement of Exit Capacity Assignments'

UNC modification 0755S introduced the ability for one user to assign capacity in part to another user – previously the UNC only facilitated assignment in full. This required a change to be made to the ExCR to align with the UNC. The Independent Examiner noted that this has been through the industry governance process required to make a UNC modification, including consideration that a consequential change to the ExCR would be required. They also stated that it appears to better reflect NGG's duties and obligations.

#### Our views

We agree with NGG that the proposed change is necessary to align with the UNC.

### Independent Examiner's additional observations

The Independent Examiner also referred to some findings from their 2019 Report which were repeated in their 2021 Report, that they consider have not yet been addressed. One of these was that there is limited evidence that it is economically efficient to allow NGG to withhold obligated capacity from daily auctions, while observing that NGG considers this action a last resort and it does not undermine their overall goal of using all reasonable endeavours to avoid constraints and release obligated capacity. Another observation was that the first-come, first-served allocation of enduring annual capacity and the fact that annual capacity requests during the application window are pro-rated (where requests exceed available capacity) may not be economically efficient but are consistent with the UNC.

### Our views

We consider that the above findings from the 2019 Report are still to be addressed by NGG. While we agree with the Independent Examiner that these issues are not material for NGG to fulfil its obligations, we expect action to be taken to reduce the potential inefficiencies identified in future.

### **Our Decision**

Following consideration of the documentation you have provided, the Authority approves the Exit Capacity Release Methodology Statement in accordance with Special Condition 9.18.12 and having regard to the Authority's principal objective and statutory duties.

This letter has been made available on our website.

You can contact Connie McKeever at [connie.mckeever@ofgem.gov.uk](mailto:connie.mckeever@ofgem.gov.uk) if you have any further questions about this decision.

Yours sincerely,

**Bogdan Kowalewicz**  
**Senior Policy Manager, Core Gas Access and Charging**