

Offtake Arrangements Regulatory Impact Assessment

Response by NGT, 9th July 2004

NTS Exit Capacity

Option 2B: NTS connects booking model

(with direct payment flow between DN shippers and the NTS)

1. Introduction

This Appendix describes our initial thoughts on how Option 2 B could be developed into a viable framework for the release of NTS exit capacity.

The overall objectives are to:

- Supplement investment signals for transmission
- Enable DNs to efficiently match NTS exit capacity to DN transportation needs
- Enable allocation of NTS exit capacity without undue discrimination
- Avoid obstacles to retail competition

NGT anticipates that the objectives would best delivered by developing and operating common processes wherever possible. To that extent we believe that a common definition of firm NTS exit capability should be developed for use across all NTS exit points. At its most basic NTS exit capacity would be expressed as the maximum level (kWh) of energy that can be demanded for use during a pre-specified day and at a pre-specified location.

There are many parallels with the current entry capacity regime, and the licence and Network Code provisions underpinning entry arrangements can be used to inform the likely requirements for exit reform. In particular, key regulatory developments to facilitate NTS exit reform include NTS incentive arrangements for capacity release and DN incentive arrangements to ensure efficient demand levels for the NTS exit capacity product. The interaction with the 1 in 20 pipeline security standard obligation requires careful consideration. Related to these aspects is the development of appropriate product pricing methodologies.

This appendix describes the Option 2B NTS exit capacity product and arrangements associated with its release. A high level implementation plan involving phased introduction consistent with system development requirements is outlined. The application to NTS direct connect exits and NTS/ DN exits is considered. The distinction is necessary to reflect the fact that DNs must play a significant part in the arrangements at NTS/ DN exits to satisfy their 1 in 20 pipeline security standard licence obligations. Finally some further key considerations in developing the option are highlighted.

2. Option 2B NTS Exit Capacity Product and Release Arrangements

At the most basic level the NTS exit capacity product can be defined as the maximum daily quantity (MDQ) that can be offtaken at an individual NTS exit point. There are a number of further aspects relating to product release that need to be addressed:

Tranching of capacity rights

Whilst the capacity right applies in respect of a particular gas flow day, it is expedient to make the product available in tranches of consecutive days' rights. A number of tranching arrangements can be considered:

- Annual
- Quarterly
- Monthly
- Daily

To cater for the seasonal variability of much of the load connected to the NTS, and the nature of the system planning process, monthly tranches of forward capacity going out number of years together with daily tranches for near term requirements are proposed.

Capacity rights timeframes

An objective of the NTS exit capacity arrangements is to facilitate efficient system planning processes, both for the NTS and downstream systems. Capacity rights must therefore be made available for a period beyond the 3-year lead-time so that system investment projects can be initiated in a timely manner. It may be prudent to offer capacity for a longer period so that an advance indication of demand could be received before NTS commits to any investment, although we note that this process has not been entirely successful at entry. We also consider that, depending upon the formulation of a test to validate the release of NTS exit capacity (perhaps in accordance with an incentive), NTS might be required to offer exit capacity for longer durations. The interaction with the requirement for the DN to book 1-in-20 needs to be considered.

Constrained and unconstrained capacity availability

Capacity rights within the investment lead-time should be considered as a constrained product, as additional capacity cannot physically be provided. Where demand exceeds a capability level, it would be for NTS to decide on release of capacity above capability. For product beyond the investment lead-time there would be unconstrained availability.

Substitutability

NTS exit capacity is location dependent. Whilst there is some scope to aggregate to a certain degree (for example the individual NTS/ DN offtakes associated with certain LDZ exit zones) NGT does not envisage a regime where capacity can be exchanged across widely different geographical locations. If necessary, the interactions could be reviewed on a case-by-case basis as has been proposed for similar electricity arrangements (CUSC amendment proposal CAP068).

Taking account of the factors discussed above, Option 2B could have the following features:

There would be three distinct types of capacity sale, dependent on the period for which the capacity rights are to apply.

Daily rights

- Daily tranches made available close to the day
- Constrained availability
- Auction process with reserve price

Short term rights

- Made available once each year (probably in the summer)
- Rights apply to gas years 1, 2 and 3 (i.e. within investment lead time; gas year 1 begins on the 1 October immediately following the summer in which the capacity is made available)
- Monthly tranches
- Constrained availability
- Auction process with reserve price

Long term rights

- Made available once each year (probably in the summer)
- Rights apply to gas years 4 and beyond (i.e. beyond investment lead time)
- Monthly tranches
- Unconstrained availability
- Price/ quantity curve
- Incremental capacity release criteria

In addition, shippers would be able to acquire capacity at NTS direct connects from another shipper through trading arrangements.

3. Outline Implementation Plan

Making NTS exit capacity available on the long term, short term, and daily bases described above requires the development of supporting systems that will not be available until summer 2007. The new arrangements would therefore apply to all years from 2007/8 onwards.

However if the licence and pricing arrangements are clarified in the near future, it may be possible to administer the sale of long term rights in summer 2005 in respect of the investment critical years (from October 2008 and beyond) using processes supported by less robust systems. This would enable NTS planning to take into account forward bookings made by shippers at NTS direct connect exits, and requirements specified by DNs at NTS/ DN exits. This would be a high risk approach if long term rights were made available several years into the future, so longer term registration may need to be limited.

Table 1 shows the introduction of the new forms of capacity release in respect of year 2007/8 onwards. For shippers, the existing NTS exit capacity arrangements at both NTS direct connect exits and NTS/ DN exits would continue to apply for the years 2005/6 and 2006/7.

For system planning purposes, it is envisaged that the Offtake Code will on its introduction specify agreed minimum levels of monthly NTS exit capacity for each DN for the years 2005/6, 2006/7 and 2007/8 (in effect equivalent to short term rights under the new regime). The Offtake Code will specify the process for annual update of these figures (again in a similar manner to the short term rights process under the new regime) until the new regime is implemented in full in summer 2007.

Time at which capacity rights made available	Type of rights and year in respect of which rights apply					
	2005/6	2006/7	2007/8	2008/9	2009/10	2010/11
Summer 2005	Current arrangements	–	–	New long term rights release if interim system support	New long term rights release if interim system support	New long term rights release if interim system support
Summer 2006	x	Current arrangements	–	–	New long term rights release if interim system support	New long term rights release if interim system support
Summer 2007 Full system functionality available	x	x	New short term rights release New daily rights release	New short term rights release	New short term rights release	New long term rights release
Summer 2008	x	x	x	New short term rights release New daily rights release	New short term rights release	New short term rights release

4. Arrangements for NTS direct connect exit points

It is envisaged that shippers would acquire capacity through the long term, short term and daily release processes described above. A shipper would commit to pay for capacity registered to it under each release process at the price established at that time. Overrun charges would continue to apply in respect of any day on which the registered capacity was exceeded by actual flows.

5. Arrangements for NTS/ DN exit points

DN specification of NTS Exit Capacity requirements

For each individual NTS/DN exit point the aggregate NTS exit capacity requirements for the following years would be established by DNs under the Offtake Code arrangements. The opportunities to register NTS exit capacity would be as described in Table 1.

The capacity levels specified by a DN in respect of any year would be the requirements to satisfy its 1 in 20 pipeline security standard licence obligation. This obligation could impact on booking levels throughout the year.

The number of years into the future that requirements were specified would depend upon the economic test for capacity release.

Allocation of quantities of NTS exit capacity to DN shippers

The final aggregate NTS exit capacity requirement specified by a DN in respect of an NTS/ DN exit point on a particular day is an important parameter used to determine the NTS exit capacity held by a shipper and the associated charges. The final requirements specified by the DN under the Offtake Code will be apportioned amongst shippers using an approved methodology set out or referenced in the Uniform Network Code. The calculation could, for example, pro-rate final aggregate capacity based on the aggregate quantities of LDZ exit capacity (for both DM and NDM load) in the relevant LDZ held by the shippers at the time the NTS exit capacity is used. The charges payable by shippers to the NTS would reflect both the quantities of NTS exit capacity so apportioned, and the prices for capacity applicable when the DN specified the requirement.

Overrun charges at NTS/ DN exits would in effect be funded by DNs, as shippers have no latitude to adjust the quantities of NTS exit capacity apportioned to them. However, these would be structured as overrun payments by shippers to NTS, offset by a DN charge rebate to shippers, to ensure payment flows for NTS exit capacity remain between NTS and shippers. The payments would reflect the overrun of actual flows against the final aggregate NTS exit capacity requirement specified by the DN.

6. Key issues for further consideration

A number of key issues requiring further consideration are discussed below:

Location

Exit capacity may need to be offered at the level of individual offtake from the NTS/DN in order that actual flows can be compared to booked capacities and that efficient investment signals can be determined. However, we note that the trade off between exit zones and offtakes would manifest itself in differing levels of commercial and systems complexity.

Baseline capacity

Implementation of a new NTS exit capacity regime will require careful consideration of whether baseline quantities need to be expressed for each NTS exit point rather than by zone. Also directly connected NTS loads may need to be specified individually rather than in aggregate.

NTS exit incentive

It is appropriate to consider what incentives, if any, should be placed upon the NTS to respond to demand for incremental exit capacity. The incentive will ideally address the level of economic judgement that NTS should apply before releasing incremental exit capacity. The interaction of this with the DNs obligation to book 1-in-20 levels will need to be fully explored prior to any implementation. A potential complication for any capacity release test is whether NTS should consider demands at each offtake in isolation or whether demand signals could be aggregated across wider geographic areas. The incentive arrangements should be fully understood before implementation of any new arrangements.

It may also be appropriate to develop a separate (or modify the existing) incentive to encourage appropriate use of constraint management tools. The incentive might also require the development of new capacity neutrality arrangements if the interests of shippers and/ or DNs are to be aligned with the objectives of the incentive.

DN incentive

Consideration of the incentive for DNs to demand an efficient level of NTS exit capacity will be of particular importance as DNs in effect determine the levels of NTS exit capacity shippers pay for. We anticipate that an incentive would reward DNs for making appropriate trade offs between NTS exit capacity and available interruption within the DN.

Security of Supply Obligation

We agree that DNs should have an obligation to demand NTS exit capacity (on behalf of their shippers) to a level that is consistent with their expectation of 1 in 20 demand. The respective pipeline security standard obligations of both the NTS and DNs need to be clearly set out before capacity release processes commence.

Pricing

A release process that is designed to enable supply to be expanded to match demand will arguably need to signal a range of prices that are broadly reflective of the costs of providing additional increments above existing capability. A methodology would need to be developed to produce prices, and network capabilities will also need to be identified at each NTS exit point.

Shorter-term capacity release might be conducted with different pricing arrangements. We consider that understanding the relationship between long and short term pricing might be a critical issue for shippers and DNs before they feel able to participate in new release processes.

We consider that the pricing arrangements would need to be developed for each individual NTS offtake. This is to reflect the complexities and choices that are available during the planning process. In addition to adding greater complexity to the pricing process this will also necessarily need to be reflected in the number of auctions etc that could be operated.

Ancillary Agreements

There are certain ancillary agreements to the Network Code that specify capacity booking rules for particular NTS direct connect exits. These may need to be reviewed and modified before a new capacity release process could be introduced at that location.

Retail Competition

Under the present arrangements only the registered shipper(s) at an NTS direct connect supply point may book capacity. There are provisions for the shipper to amend capacity levels, but the capacity rights lapse when the shipper is no longer the registered shipper for that supply point. In implementing a longer-term capacity regime, capacity booking and supply point registration (which identifies the current shipper) may need to be de-linked. The shipper holding the long term rights would be committed to pay for the rights irrespective of whether the same shipper is the registered shipper at the supply point at the time the rights become usable. This raises questions of market power and risk for shippers and the need to address these issues through some form of safeguard such as use-it-or-lose-it provisions.

Shipper opportunity to request NTS exit capacity at NTS/ DN exit points

The RIA document suggests that Option 2 could be developed such that there is an opportunity (but not the obligation) for shippers themselves to request NTS exit capacity at NTS/ DN exit points. The additional benefits this might provide are not apparent to NGT.

We do not consider that shippers would have sufficient information to know which offtakes feed their loads, and as a consequence they would not be able to understand the range of choices afforded to them. This is reinforced by a lack of locational charging signals offered by the present DN charging arrangements. For the introduction of bookings directly by shippers to be beneficial, there would need to be radical changes to the operation and to the charging arrangements within the DNs. This needs further consideration before such an option can be assessed. The arrangements would also introduce additional complexity (and hence cost) into the capacity release and billing processes. Finally, the arrangement appears to be, in all material respects, a variation on Option 3 rather than Option 2.