

# Entry Capacity Regime – next steps?

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# AGENDA

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- ◆ Principles behind the entry regime
  - ◆ Theory & practical experience
- ◆ Key areas for consideration
  - ◆ Baselines
    - ◆ Purpose of baselines
    - ◆ Key principles and current observations
  - ◆ Revenue Drivers
    - ◆ Purpose & principles behind revenue drivers
  - ◆ Buy-backs
    - ◆ Risk sharing and incentivisation
- ◆ Summary

# Principles behind Entry regime

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- ◆ Shippers signal demand and provide a firm financial commitment for capacity
- ◆ Main two purposes of the auctions were to:
  - ◆ Provide a method for non-discriminatory allocation of baseline capacity
  - ◆ Allow shippers to provide signals for Long Term requirement
- ◆ National Grid incentivised to deliver requested capacity requirements in a timely manner
- ◆ Based on finite rights – no grand-fathering
- ◆ No barriers to entry for new players
  - ◆ Reservation of some capacity (20%) for new entrants
- ◆ All based around premise of additional growth at existing terminals

# What has happened in reality (1)

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- ◆ **Shippers signal demand and give firm financial commitment:** ✓
  - ◆ but weakened by zero-priced capacity on the day
  - ◆ NPV test can influence auction bids
- ◆ **National Grid incentivised to deliver investments in a timely manner through the buyback mechanism:** ✓
  - ◆ but currently no explicit allowance for new ASEP buyback risk
  - ◆ consider elements outside National Grid control (eg consents)
- ◆ **Main two purposes of the auctions were to:**
  - ◆ Provide a method for non-discriminatory allocation of baseline capacity ✓
  - ◆ Allow market players to provide signals for LT requirement ?

# What has happened in reality (2)

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- ◆ **Based on finite rights – no grand-fathering** ✘
  - ◆ High baselines combined with obligations to offer until end of gas day means not achieved – effectively grand-fathering by another means
- ◆ **No barriers to entry for new players** ✘
  - ◆ Reservation of some capacity (20%) for new entrants
    - ◆ Worked at existing terminals, but questionable for new terminals
- ◆ **All based around premise of additional growth at existing terminals**
  - ◆ Seen no incremental obligated capacity at existing terminals, only creation of new entry points

# What is National Grid's obligation as regards Entry?

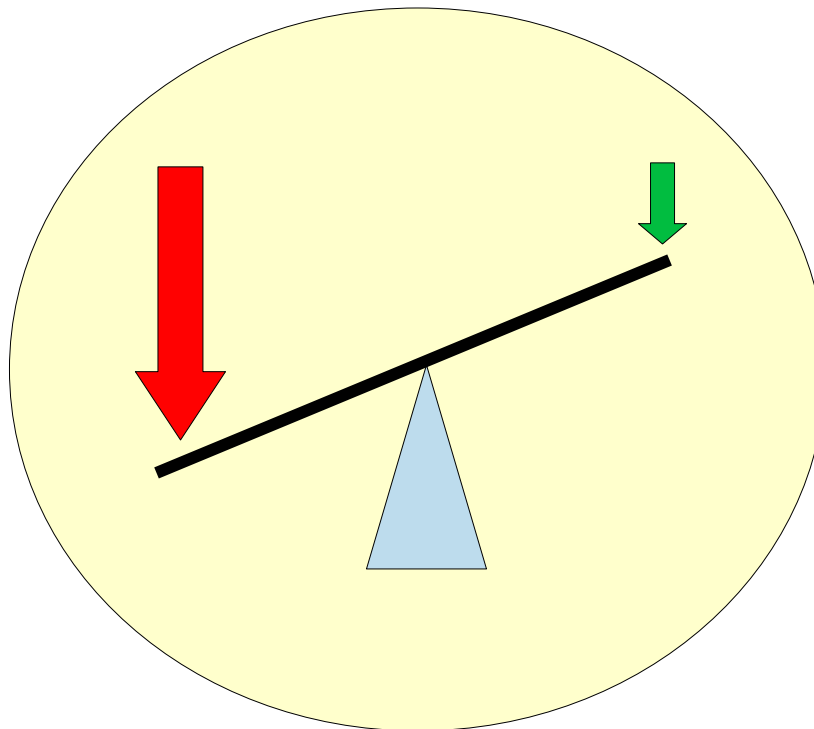
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- ◆ Explicit licence obligations
  - ◆ Standard Special Condition A9
    - ◆ “1 in 20” obligation
  - ◆ Standard Special Condition A11
    - ◆ “economic and efficient” obligation
- ◆ Implicit obligations and explicit incentives to take account of auction signals
- ◆ Need to be clear what overall obligations are and how they interact
  - ◆ For example, does timely response to auction signals discharge the economic and efficient obligation with regards to new capacity?

# Balance between Obligations and Remuneration

## Obligations

- 1 in 20
- Economic and efficient
- Take account of auction signals
- Offer in at least one clearing allocation
- Must buy-back if capacity not available



## Remuneration

- Limited upside due to NPV test (auction bids  $\approx$  6.25%)
- Potential returns up to 12.25% not reachable in reality
- No explicit funding for buy-back at new entry points

# Purpose of baselines

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- ◆ For National Grid, determines allocation of revenue:
  - ◆ Baseline obligations should reflect remuneration through price control
  - ◆ Above baseline obligations should be remunerated separately
- ◆ For shippers, determines:
  - ◆ Availability of NTS capacity through obligations on National Grid
  - ◆ Price of obtaining NTS capacity

# Principles for baselines (1)

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- ◆ Setting baselines creates obligations and therefore consequences need to be understood
- ◆ Currently believe baselines should not exceed the physical capability of the system
- ◆ Current Observations:
  - ◆ Issues arise from the methodology used at last TPCR
  - ◆ NTS cannot support coincident flows at current baselines

# Principles for baselines (2)

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- ◆ Potential next steps:
  - ◆ Could remunerate investment to meet current baselines as part of TPCR
  - ◆ Could reduce baselines to a level equivalent to physical capability
  - ◆ Need to consider the overall balance of obligations and remuneration

# Purpose & Principles of revenue drivers (1)

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- ◆ Two main purposes:
  - ◆ Mechanism for dealing with uncertainties at periodic price controls
  - ◆ Mechanism to amend revenue for providing outputs beyond those agreed and funded via the price control
- ◆ Principles:
  - ◆ Should reflect the costs associated with delivering outputs beyond those agreed at the price control
  - ◆ Could be a direct function of the commercial arrangements with shippers or decoupled (i.e. a revenue driver)

# Purpose & Principles of revenue drivers (2)

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- ◆ Current observations
  - ◆ Revenue drivers serve a useful purpose which should be extended to electricity
  - ◆ As a matter of principle they should reflect costs but can be a direct function of the commercial arrangements with shippers or decoupled
  - ◆ Current Entry mechanism fundamentally works but UCAs no longer cost reflective as costs change
- ◆ Potential next steps
  - ◆ Build on existing mechanism with Ofgem to develop more cost reflective UCAs for revenue purposes
  - ◆ Consider role of UCAs and pricing

# Buybacks

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- ◆ Level of potential buybacks can be influenced by:
  - ◆ Level of baselines
  - ◆ Timescales associated with delivering new entry capacity
  - ◆ Who bears the risks associated with significant external challenges (eg obtaining consents/easements)
- ◆ What level of compensation is appropriate for buying back capacity?
- ◆ How should the compensation for buybacks be funded?
- ◆ Is there merit in a separate buyback pot for operational purposes and new investments?

# Summary

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- ◆ Important to be clear on overall obligations on National Grid under which the Entry regime exists
- ◆ Important to review the principles behind the entry regime (both in theory and practice) against the future environment
- ◆ Full industry involvement important on which aspects of the regime are valued and could be improved
  - ◆ National Grid interested in industry views and how we can be appropriately incentivised to deliver aspects of the regime which are valued by the market
- ◆ Believe there is an inextricable link between the level of obligations and the level of remuneration
  - ◆ Any options regarding baselines and buybacks need to consider the level of remuneration at the same time as any obligations