TPCR second consultation: gas offtake

EOWG 1

4 January 2006

Outline

1. Objectives and timetable
2. Transitional arrangements and rationale for change
3. Enduring offtake arrangements – December consultation options
4. Further issues

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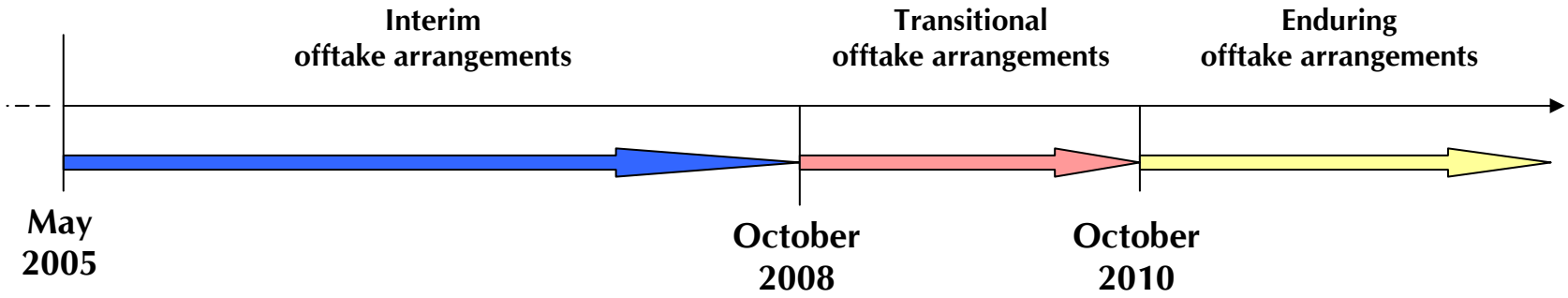
Enduring NTS offtake arrangements: key objectives

Compliance with applicable legal objectives	Gas Act, Electricity Act, European law
Promote economic and efficient network development and system operation	Transmission companies should respond to changing demands of customers, optimising use of existing capacity, and backed by appropriate commitments from users
Prevent undue discrimination (both between DNs and between DNs and other NTS direct connectees)	Need consistent NTS offtake arrangements to apply to DNs, NTS direct connectees and new connections
Promotion of competition	Arrangements should, to appropriate extent, promote competition between participants
Preserve security of supply	Ensure arrangements manage short and long term security of supply efficiently

Revision of offtake arrangements timetable

- Initial auctions delayed to autumn 2007 (for sale of NTS exit capacity rights for Oct 2010 onwards)
- This will enable:
  - Consideration of interactions between entry and exit arrangements in line with NTS price control process
  - More consultation on detail
- Consistent with principles of better regulation

Timetable for offtake arrangements



- Current interim offtake arrangements apply until end September 2008
- "Transitional arrangements" to apply from October 2008
- Start of enduring offtake arrangements delayed until October 2010 (first auction held Autumn 2007)

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Transitional offtake arrangements

- Transitional arrangements address incremental investment and triggering of incremental capacity release for 2008-10
- Transitional arrangements include:
  - DNs and shippers commit financially to capacity if their request requires the NTS to undertake investment, reducing stranded asset risk
  - Ofgem responsible for dispute resolution
  - Existing direct connectees continue to have option to roll-over existing level of access rights at end of year
  - Also, incentives on DNs to expose them to costs of booking NTS exit capacity.

Transitional arrangements – ongoing concerns

- Existing direct connectees retain option to rollover offtake rights
  - arrangements potentially discriminatory
  - creates a risk of stranded assets, in absence of long term financial commitments for *all* NTS connectees
- Increased regulatory burden
  - Potential for Ofgem to become involved in disputes over investment and allocation of capacity
  - Disputes also create regulatory uncertainty for connecting parties
- Weak incentives on NTS
  - Limited incentives for NTS to substitute NTS pipeline capacity for storage or interruption

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Enduring offtake arrangements

- Aim is to remove ongoing distortions of transitional regime
- Key principles are:
  - Unconstrained allocation of capacity to NTS users in long run
  - Constrained allocation of capacity to NTS users in short run
  - Potential for commitment from all NTS users

Enduring offtake arrangements: key principles

Long term

- **Unconstrained allocation** of capacity
- Typically occurs in time that is consistent with investment planning timescales
- Users can choose to commit to use NTS capacity at this time – *guaranteed access at regulated price.*
- Provides investment signal to NTS. It builds, if necessary, to meet user demands as there is sufficient time available.

3 years ahead (ish)

Short term

- **Constrained allocation** of capacity
- NTS does not have sufficient time in this period to invest to meet all user requests
- Users may apply for remaining unsold NTS capacity
- If demand exceeds that available NTS will have to ration access in non-discriminatory manner (i.e. price)

Gas day

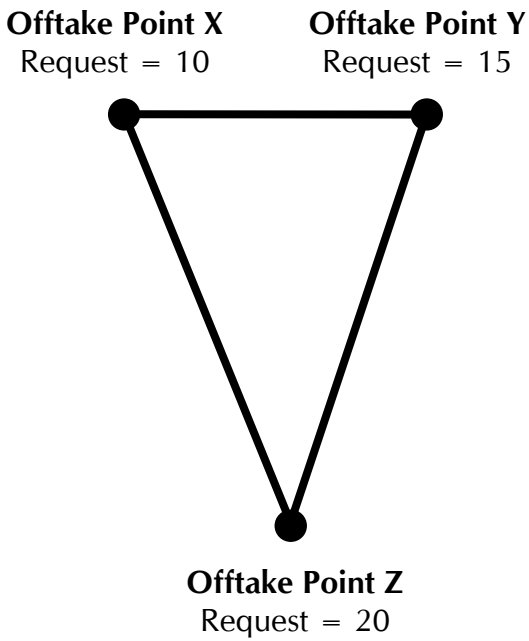
Proposed enduring offtake options

- Status Quo based on transitional arrangements (comparator for IA)
- Other proposed options involve "user commitment" and are differentiated by:
  - Spatial definition of baselines (nodal, zonal or global)
  - Spatial definition of products (nodal or zonal)

	Status Quo	**Long term user commitment models**			
	Option Ex1	Option Ex2	Option Ex3	Option Ex3A	Option Ex4
Baseline	(LDZ)	Nodal	Zonal	Global/ network wide	Zonal
Product definition	Nodal	Nodal	Nodal	Nodal	Zonal
Substitution	×	✓	×	×	×

Offtake options: worked examples

- In this simple stylised example of the long-term allocation process, assume a network contains 3 offtake points, with 1 connectee at each offtake point
- Nodes X and Y are relatively close (assume perfectly substitutable)
- Node Z is relatively distant (assume no opportunity to substitute with either X or Y)
- At the 3-year ahead stage, assume that the three connectees submit requests for offtake capacity as illustrated
- Baseline allocations, and investment triggers differ according to the offtake option selected…

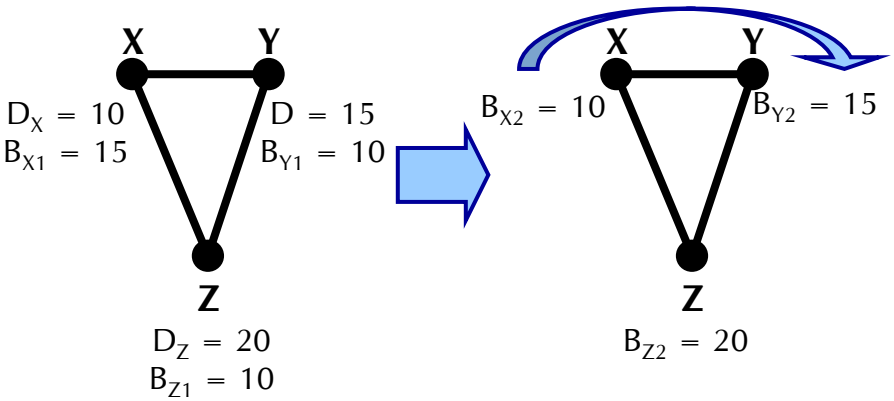


Offtake options: worked examples

Option EX2

(Nodal baseline / nodal product)

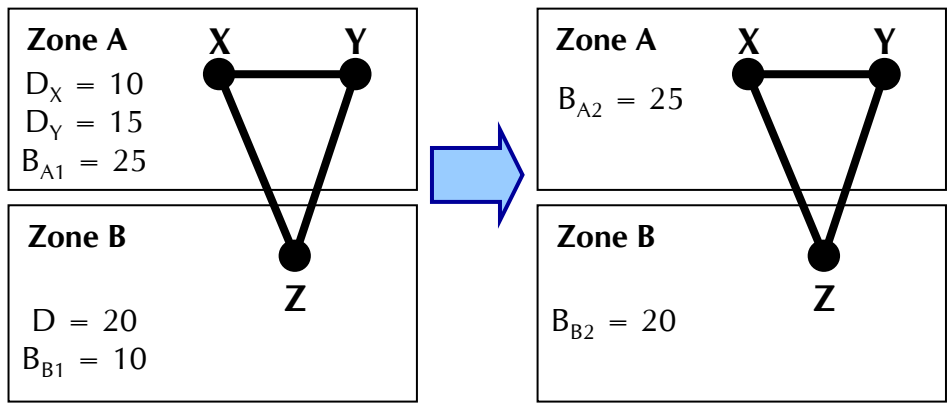
- Nodal baselines set prior to initial allocation
- Substitution incentive on NTS, to allocate nodal baselines across the network consistent with demand
- Baseline allocated from Node X to Node Y (at an implied exchange rate of 1:1)
- Baseline at Node Z increased by incremental investment



Option EX3

(Zonal baseline / nodal product)

- Zonal baselines set for Zone A and Zone B prior to initial allocation
- NTS allocates existing *zonal* capability to meet demand for *nodal* products
- Total demand in Zone A equals existing baseline
- Incremental investment triggered in Zone B

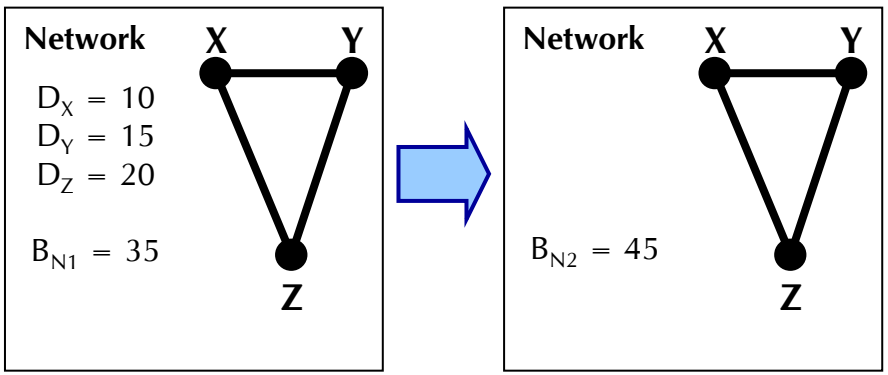


Offtake options: worked examples

Option EX3A

(Network baseline / nodal product)

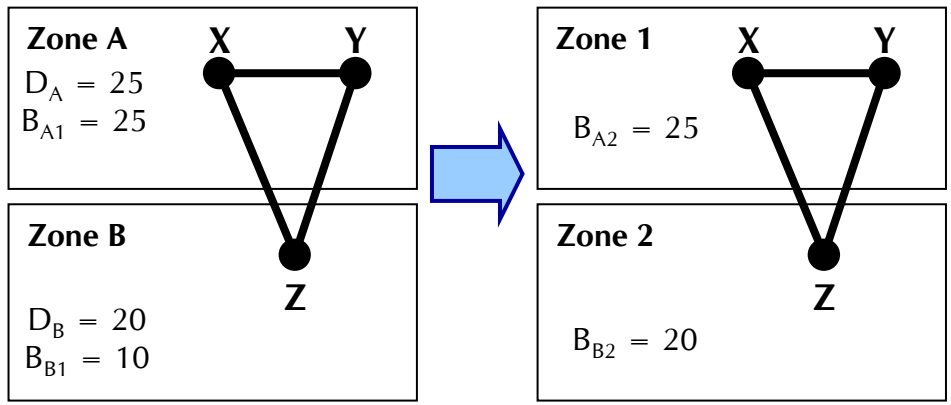
- Single baseline figure set for the entire network
- NTS allocates existing *network* capability to meet demand for *nodal* products
- In this example, demand across the network exceeds baseline
- Investment is triggered at offtake point Z, raising network baseline to 45



Option EX4

(Zonal baseline / zonal product)

- NTS allocates existing *zonal* capability to meet demand for *zonal* product
- Total demand in Zone A equals zonal baseline
- Investment is triggered in Zone B, raising baseline at this zone to 20



User commitment models

Model	Advantages	Disadvantages
Option Ex2 (nodal / nodal)	▪ efficient investment decisions ▪ maximise the use of the existing network ▪ encourage long term purchasing	▪ costly substitution incentive / exchange rates ▪ potentially complex ▪ Information asymmetries could cause significant problems (e.g. baselines)
Option Ex3 / 3A (zonal or global / nodal)	▪ efficient investment decisions ▪ flexibility for NTS to allocate baselines ▪ encourage long term purchasing and competition ▪ simpler than model EX2	▪ little substitution between zones ▪ greater discretion to NTS ▪ need to monitor NTS exercise of discretion
Option Ex4 (zonal / zonal)	▪ Promote trading of zonal offtake rights ▪ encourage competition ▪ promote efficient allocation capacity amongst market participants	▪ higher buyback costs ▪ less accurate investment decisions ▪ potential security of supply issues

Enduring NTS incentives

- Dependant upon model of arrangements selected (e.g. substitution incentive required?)
- Relate to long term and medium/short term provision of both flat and flexible capacity
  - Long term incentive to provide incremental investment requested on the network
  - Medium / short term incentive to ensure maximum quantity of flat and flexible capacity is released within investment timescales, and efficient buy-backs of capacity where necessary
- Choice of revenue driver for incremental capacity provision to be determined (global, zonal or nodal?)

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Further issues

- Product definition – flat and flexibility
- European regulations
- Bi-directional flows
- Pricing