Assumptions for the proposed options for enduring offtake

This assumptions document has been developed to support the proforma questionnaires on the costs that would arise from the implementation of enduring offtake reform and the associated incentives outlined in our Updated Proposals[1].

On 20 October, Uniform Network Code (UNC) Modification Proposal 0116 (Reform of the NTS Offtake Arrangements) which had been raised by NGG NTS, was issued for consultation. Three alternative UNC Modification Proposals were also issued for parallel consultation:

- Modification Proposal 0116A, raised by E.on UK, which proposed the retention and extension of the transitional offtake arrangements;
- Modification Proposal 0116B, raised by RWE Trading, which proposes certain amendments to the NGG NTS proposals; and
- Modification Proposal 0116C, raised by BGT, which proposes certain further amendments to the NGG NTS proposals.

We note that, on 8 November 2006, NGG NTS, raised a proposal to vary Modification Proposal 0116 by introducing minor amendments and clarifications.

This assumptions document is intended to enable respondents to the pro forma questionnaires to develop cost estimates on a consistent basis such that Ofgem is able to assess each of the modification proposals above.

The document is structured as follows:

- a **background** section;
- an overview of the **proposals for offtake arrangements**; and
- a summary of the **key implications for industry participants**.

Background

Within our TPCR Initial Proposals, published in June 2006 (the Initial Proposals)[2] we presented a draft cost benefit analysis, evaluating the net present value (NPV) impact of the high-level proposals presented in the Third Consultation[3] relative to the **transitional** offtake arrangements.

As stated above, on 20 October, UNC Modification Proposal 0116 (Reform of the NTS Offtake Arrangements) which had been raised by NGG NTS, was issued for consultation along with three alternative Modification Proposals raised by E.on UK, RWE Trading and BGT respectively.

We recognise that in order to provide detailed and consistent cost estimates, respondents need to understand the implications of the arrangements proposed for their business. To this end, this assumptions document:

---

[1] *TPCR 2007-2012 Updated Proposals*, September 2006 (Ref No. 170/06)
TPCR 2007-2012 Updated Proposals, Appendices, September 2006 (Ref No. 170/06a)
[2] *Transmission Price Control Review: Initial Proposals*, Ofgem, June 2006, 104b/06
[3] *Transmission Price Control Review 2007 – 2012: Third Consultation*, Ofgem, March 2006, 51/06

- focuses upon the detailed proposals for enduring offtake arrangements and incentives given the UNC Modification Proposals currently being consulted upon in this regard; and

- outlines likely implications for key industry participants.

We recognise that proposals for enduring offtake reform are currently being consulted on through the UNC modification process and that Ofgem cannot fetter the discretion of the Authority with respect to the proposals that have been raised. As such, the information contained in this paper is not binding on the Authority. Nothing in this paper is to be construed as granting any rights or imposing any obligations on the Authority. The Authority's discretion in this matter will not be fettered by any statements made in this paper.

Proposals for offtake arrangements

The pro forma asks respondents to evaluate the cost of the detailed proposals presented in our Updated Proposals and the relevant UNC Modification Proposals. In this section we describe in turn:

- the definition of the **transitional** offtake arrangements which are consistent with the E.on Modification Proposal (0116A) and retention of transitional incentives outlined in our Updated Proposals; and

- the **enduring offtake arrangements**, which are consistent with NGG NTS Modification Proposal 0116 (as varied) and our Updated Proposals.

In their alternative Modification Proposals (0116B and 0116C), RWE Trading and BGT stated that if Ofgem decide that Modification Proposal 0116 does better facilitate the achievement of the relevant objectives, Ofgem can then consider whether alternative Modification Proposals 0116B and 0116C do so more strongly. However, they emphasised that, if Ofgem decide that Modification Proposal 0116 does not better facilitate the achievement of the relevant objectives, then neither should alternative Modification Proposals 0116B or 0116C. As such, the focus of the pro forma is on assessing Modification Proposal 0116 against the transitional offtake arrangements.

However, we note the key differences between Modification Proposal 0116 and alternative Modification Proposals 0116B and 0116C at relevant points in the description that follows and we would be grateful if respondents could highlight any areas where such differences could have material cost implications (quantifying the potential impact where possible).

Transitional offtake arrangements

The transitional arrangements are the arrangements and associated incentives in place in relation to capacity released between 1 October 2008 and 30 September 2010[4].

GDNs

Under the transitional arrangements, GDNs are required to make requests for both the retention of existing capacity and the addition of new capacity for annual tranches

[4] See *Final proposals on transitional incentive schemes and formal licence consultation under section 23 of the Gas Act 1986 and paragraph 3(a) of Standard Special Condition A2,* Ofgem, November 2005.

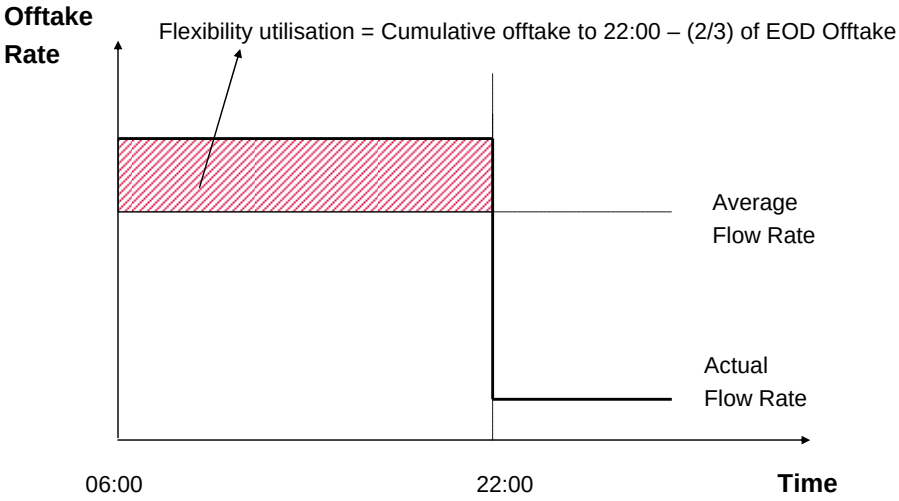
of capacity (defined by gas year) at the three year ahead stage and such requests can be revised each year during June / July.

NTS exit capacity is defined and booked as two separate products:

- NTS exit flat capacity, which will give the holder the right to offtake a volume of gas during the day at a constant hourly rate, and

- NTS exit flexibility capacity, which will give the holder the right to offtake gas from the NTS according to a profile that varies across the day. This product is defined as being equal to the cumulative volume of gas taken in excess of the average flow rate, over the period 6am to 10pm, allowing for a tolerance of 1.5% on measurements of the cumulative flow, and is illustrated in Figure 1 below.

Figure 1: Definition of the NTS exit flexibility capacity product



Where incremental capacity requests from GDNs are judged by NGG NTS to trigger additional investment over and above defined 'initial volume allocation' thresholds, GDNs must enter into an Advance Reservation of Capacity Agreement (ARCA) with NGG NTS. The terms of this agreement are a result of bilateral negotiations between NGG NTS and the relevant connectee. However, Ofgem has an important role in settling any disputes that may arise on the terms of the ARCAs.

In addition, GDNs are required to comply with a specified set of restrictions regarding the way in which their offtake is profiled through the day (as outlined in the Offtake Arrangements Document (OAD)).

GDN shippers

At present, the process of payment flows means that it is necessary for GDN shippers to pay separately for transmission and distribution exit capacity charges with such charges being levied by NGG NTS and the relevant GDN.

TCC shippers

TCC shippers purchase a bundled "NTS exit capacity" product (with an associated Maximum Hourly Quantity (MHQ)) on behalf of their customers rather than separate products for NTS exit flat capacity and NTS exit flexibility capacity.

NTS interruptible status continues to be available to TCC shippers on request, consistent with current arrangements.

NTS daily metered (DM) supply points

Capacity is allocated in respect of NTS DM supply points on an "evergreen" basis with no renewal process required.

System offtake quantity (SOQ) can only be reduced within the "capacity reduction period" which runs from October to January and cannot be reduced below the previous winter's maximum daily consumption.

SOQ increases (defined in periods of a month) are subject to an assessment of system capability (following booking one month in advance) or whether the capacity had been previously reserved via an ARCA entered into by the TCC shipper or the TCC itself.

NTS connected system exit points (CSEPs)

NTS exit capacity is booked by the relevant shipper on a 12 monthly rolling basis. The shipper can apply for either a new amount, an annual renewal or an increase in the current amount no earlier than 6 months, nor later than 4 days prior to the proposed registration date. Proactive renewal of existing capacity is required and such capacity rights will expire automatically after 12 months. During the 12 month capacity period, the level of NTS exit capacity cannot be reduced nor the registration terminated. Trading is facilitated by shippers at the CSEP.

NTS interconnectors

The processes applied with respect to NTS interconnectors are broadly the same as for other NTS CSEPs, other than the administration of a Downstream Capacity Holder voucher scheme. Any applications for capacity, and requests for transfer of capacity, must be accompanied by a valid voucher.

NTS storage sites

At present, all transportation at storage connection points are treated as "interruptible". Storage users are required to register their peak offtake amounts. However, shippers may book firm capacity.

TCCs

In addition, TCCs are required to comply with a specified set of restrictions regarding the way in which their offtake is profiled through the day (as outlined in their individual Network Exit Agreements (NExAs)).

Where TCCs wish to reserve incremental capacity which requires additional investment, they must enter into an ARCA with National Grid NTS. The terms of this agreement are a result of bilateral negotiations between National Grid NTS and the relevant connectee. However, Ofgem has an important role in settling any disputes that may arise on the terms of the ARCAs.

The costs of the detailed proposals presented in the final decision document should be assessed against these transitional arrangements.

Enduring offtake arrangements - proposals

It is important to reiterate that this document has been provided to aid the completion of the cost survey. For the avoidance of doubt, nothing in this description should be construed as granting any rights or imposing any obligations on the

Authority, and the Authority's discretion will not be fettered by any statement made in this document.

For further detail of the arrangements under consideration, please refer to the relevant UNC Modification Proposals (0116, 0116A, 0116B and 0116C) and Ofgem's Updated Proposals.

Following the Initial Proposals document in June, NGG NTS has developed two separate NTS exit capacity products and proposes that these NTS exit capacity products will be available to all users (shippers and GDNs):

- NTS flat capacity product; and
- NTS flexibility capacity product (defined in the same way as for the transitional arrangements, as described above, except for the fact that it is zonal).

The arrangements set out in NGG NTS's modification proposal in respect of these products are discussed for each product in turn below before discussing NGG NTS's proposals for exit capacity management tools and proposals for payment flows in the enduring period.

NTS exit flat capacity

The main characteristics of the NGG NTS proposed modification for NTS exit flat capacity are:

- **Long term allocation of existing flat capacity:** existing flat capacity made available at regulated prices with existing users assumed to have "prevailing rights" for such capacity unless sufficient notice of a reduction in requirements is provided;
- **Long term allocation of new flat capacity:** new or incremental flat capacity made available at regulated prices on a non-discriminatory basis between all classes of network users with requests submitted consistent with investment planning timescales;
- **Medium / short term capacity allocation:** allocation of flat capacity rights through pay as bid auctions which occur in the period in which NGG NTS is unable to invest to address network constraints;
- **Interruptions arrangements:** interruption of flat capacity being managed by NGG NTS through the sale of a day-ahead interruptible product on a non-discriminatory basis, and through the long term contracting for the interruption of firm offtake rights;
- **Over-run charges:** over-run charges are assumed to apply where there is an aggregate over-run at an NTS exit point; and
- **Trading / transfers:** NGG NTS has proposed that a user will be able to transfer flat capacity rights between users at the same node within the constrained period.

<u>Long term allocation of existing flat capacity</u>

NGG NTS has proposed a "prevailing rights" model, which has been discussed extensively at the Enduring Offtake Working Group (EOWG). Consequently, we would ask respondents to assume a "prevailing rights" model in estimating the potential cost impact upon them. Under this model a user may have a "prevailing

level" of flat capacity, the starting level of which would be determined by the application of rules laid out by NGG NTS in its modification proposal. This "prevailing level" would be booked by default for the next 14 months at an annual application window, which would occur in July each year. However associated with this default booking of prevailing capacity levels is a financial commitment to pay 14 months' worth of capacity charges at the prevailing charge ie, the charge applying in the year that the capacity is used.

If a user wishes to deviate from this "prevailing" level of capacity, then it will be necessary to provide sufficient notice:

- if a user wishes to decrease its capacity holding below the "prevailing" level, then it will be necessary to provide at least 14 months of advance notice; and

- if a user wishes to increase its capacity holding above the "prevailing" level, then it must provide notice to NGG NTS consistent with investment lead times and follow the same process required of new users with respect to new capacity, as discussed below.

As a result of this model, any user wishing to maintain its prevailing capacity rights does not need to take any action. We therefore anticipate that the only potential costs incurred in this regard would relate to any additional credit costs over and above those currently incurred as a result of an extended period of commitment[5].

Long term allocation of new flat capacity

With respect to the allocation of new or incremental flat capacity, both new and existing users would be treated in the same way. For the purposes of responding to the cost proforma, please assume that:

- requests for such capacity increases need to be made in advance, and consistent with investment lead times – assume applications in [July] of gas year Y for use from gas year Y + 4, 5 and 6 onwards;

- to guarantee the provision of this increased level of flat capacity, the user must commit to book and pay for 4 years of capacity from Y + 4 onwards[6];

- if the user provides the required financial commitment, the increased level of flat capacity provided becomes the "prevailing" level of flat capacity, and the mechanism described above with respect to the retention of existing capacity rights shall apply;

- NGG NTS could enter into "reservation agreements" with non-UNC parties whereby the party would commit to pay the NTS Exit Capacity charges for each year required (4 years) for the reserved capacity in the event that all or part of that reserved amount is not booked by its nominated user(s) (such as shippers). NGG NTS would allow the nominated user(s) to register the "reserved" capacity for each of the 4 years in July of gas year Y for use from gas year Y + 4 onwards. Any part of the reserved capacity

[5] In estimating any credit costs, application of Ofgem's best practice guidelines should be assumed: *Best practice guidelines for gas and electricity network operator credit cover, conclusions document*, February 2005, 58/05, Ofgem.

[6] This is as stated in the draft Exit Capacity Release Methodology Statement released by NGG NTS for consultation in parallel with modification proposal 0116.

that is booked becomes part of the user's prevailing level of capacity and therefore requires 14 months' notice for reductions (subject to having met any user commitment requirements); and

- before taking the decision to invest, NGG NTS will be obliged to consider the extent to which unsold baseline capacity[7] at other offtake points could be transferred to the node where incremental capacity is requested (via application of the baseline substitution obligation), with baselines defined, by node, in accordance with a practical maximum physical methodology.

In the event that the delivery of investments is delayed requiring capacity to be bought back by NGG NTS, it is assumed that such buy back costs would be treated as excluded revenue within a determined absolute cap and subject to an administered buy back price. It is assumed that NGG NTS would be able to extend investment lead times through the application of an extension permit system as outlined in our Updated Proposals.

We note that NGG NTS has outlined two potential, alternative approaches to the quantification of the necessary user commitment for new or incremental capacity:

- under Option 1, the user commitment is based upon 4 years of prevailing prices at the time of delivery; and
- under Option 2, the user commitment is based upon 4 years of the prevailing prices at the time of application or 4 years of prevailing prices at the time of delivery, whichever is lower.

We would welcome any views from respondents regarding the extent to which the choice of either Option 1 or Option 2 would materially affect the costs incurred.

Medium / short term capacity flat allocation

It is assumed that those users who are not willing to buy capacity in the long term, consistent with investment lead times, or who require capacity on short notice, will be able to apply for NTS exit capacity within investment lead times, to the extent that it is available, through the following processes:

- annual pay as bid auctions;
- daily, and on the day, pay as bid auctions; and
- NGG NTS discretionary release.

Annual auctions for flat capacity

It is assumed that NTS exit flat capacity auctions will be held each year, whereby users are able to apply for annual firm NTS exit flat capacity for any of the gas years Y+1, Y+2 and Y+3 via a "pay-as bid" capacity auction held in August of gas year Y.

It is assumed that the quantity to be made available for each year will be:

- the remaining unsold capacity i.e. the relevant nodal "baseline" (following possible substitution of baseline obligations between nodes given application of the substitution obligation) less capacity already reserved or booked (including prevailing rights for which no notice of reduction has been given); plus

[7] Prevailing rights for which no notice of reduction has been given are classed as "sold" rights in this context.

- any non-obligated capacity (to be sold at NGG NTS discretion and in response to offered prices).

It is assumed that the reserve price will be based upon the prevailing NTS exit flat capacity charge rate.

For the avoidance of doubt, it is assumed that any capacity obtained through the annual auctions will not become or add to a user's "prevailing level" of capacity.

Daily, and on the day, auctions

The following "unbundled" capacity products will be made available for individual gas days:

- daily firm NTS flat exit capacity; and

- daily interruptible NTS flat exit capacity.

The quantity of daily firm NTS exit flat capacity to be made available is assumed, by NGG NTS, to be:

- before the start of each gas day and up to and including 8am on the gas day: consistent with the remaining unsold capacity i.e. the relevant nodal "baseline" (following possible substitution of baseline obligations between nodes given application of the substitution obligation and inter-nodal annual auction) ***less*** capacity already reserved or booked ***plus*** any additional "non-obligated" capacity that NGG NTS releases at its discretion (subject to risk assessment); and

- after 8am on the gas day: at NGG NTS discretion (subject to risk assessment).

It is assumed that the reserve price will be based upon the prevailing NTS exit flat capacity charge rate.

The following quantity of daily interruptible NTS exit flat capacity will be made available at 15:00 ahead of the gas day:

- the amount of Use-it-or-lose-it (UIOLI) capacity (determined as flat capacity holdings less the average, over a 30 day period from D-36 to D-7 inclusive, flat capacity utilisation at the exit point); and

- any non-obligated capacity that NGG NTS may make available at its discretion.

It is assumed that the reserve price will be zero.

For the avoidance of doubt, it is assumed that:

- the availability of UIOLI interruptible capacity will not, in any way, alter any firm capacity rights held by users; and

- any capacity obtained through the daily or on the day auctions will not become or add to a user's "prevailing level" of capacity.

<u>Interruptions arrangements</u>

The proposed arrangements for the interruption of capacity are summarised as:

- daily interruptible NTS exit flat capacity will be made available at 15:00 ahead of the gas day (as described above); and

- NGG NTS may, in the unconstrained period, explore opportunities for long term contracting for interruptions with users who have long term firm rights.

It is proposed that all existing interruptible sites are granted prevailing firm rights and NGG NTS will only enter into long term interruption contracts at exit points to the extent that it cannot guarantee delivery of firm capacity at those points. NGG NTS considers that such interruption contracts would only be necessary at five sites as at 1 April 2007.

The proposed non-obligated incremental capacity incentive will encourage the release of interruptible flat capacity at the day ahead stage by NGG NTS.

Flat capacity over-runs

Over-run charges are assumed to apply where there is an aggregate over-run following comparison of the aggregate flat flows on a given day with the aggregate capacity rights held at that offtake. Each user's over-run charge is then determined on the basis of each user's individual over-run. Each user's overrun charge is then determined as the "user's NTS exit flat capacity overrun" amount multiplied by the highest of:

- 8 times the highest price paid by users at the relevant NTS exit point to NGG NTS for any class of NTS exit flat capacity for that day;

- 8 times the highest reserve price at the relevant NTS exit point for any NGG NTS exit flat capacity auctions; and

- 1.1 times the highest price paid by NGG NTS exit flat capacity at the relevant NTS exit point for that day for capacity buy back through any constraint management action.

Flat trading / transfers

NGG NTS has proposed that a user will be able to transfer NTS exit flat capacity within the constrained period, subject to the restriction that firm NTS exit flat capacity at an NTS exit point is transferred to another user at the same NTS exit point.

Any accepted transfers will be deducted from the transferor's holdings and added to the transferee's holdings for the purposes of determining NTS exit capacity overrun charges and NTS exit capacity neutrality charges. The transferor user will remain liable for the payment of NTS exit capacity charges and any commitments associated with prevailing NTS exit flat capacity.

Flow swapping

It is proposed that NGG NTS will allow a GDN to request that NGG NTS accept Offtake Profile Notifications (OPNs) which will transfer, but not increase in aggregate, its NTS exit flat capacity holdings between two or more of its NTS/ LDZ offtakes within an LDZ consistent with the requested flow requirements in the OPNs.

This proposal aims to provide GDNs sufficient certainty that NGG NTS will transfer its NTS exit flat capacity between such NTS/LDZ offtakes, where it would not jeopardise the safe and efficient operation of the NTS. The proposal is intended to prevent potential inefficient over-booking of NTS flat capacity.

Variations proposed by alternative modification proposals (0116B and 0116C)

Modification Proposals 0116B and 0116C propose the following modification to Modification Proposal 0116:

- amendment to the procedures outlined in Modification Proposal 0116 with respect to the reservation, by developers, of prevailing NTS exit flat capacity such that developers are not constrained to making such applications during the July capacity application window.

We would welcome any views from respondents on the extent to which this amendment could affect the costs incurred (with quantification where possible).

NTS exit flexibility capacity

The main characteristics of the NGG NTS proposed modification for NTS exit flexibility capacity are:

- **Long term allocation of new flexibility capacity:** firm NTS exit flexibility capacity would be made available on a national basis in annual bundles of daily rights, which may be applied for and registered as held by a user in a relevant NTS exit zone for each gas day in a gas year. NGG NTS has proposed pay as bid auctions in July of each Gas Year "Y" to procure annual NTS exit flexibility capacity rights for gas years Y+1 to Y+5 (inclusive). The ability for NGG NTS to accommodate offtake flow variations and make available NTS exit flexibility capacity will continue to be constrained by the physical capability of the NTS.

- **Short term capacity allocation:** NGG NTS proposes to offer daily exit flexibility rights for sale.

- **Over-run charges:** over-run charges are assumed to apply where there is an aggregate over-run in an NTS exit zone.

- **Trading / transfers:** NGG NTS has proposed that a user will be able to transfer NTS exit flexibility capacity between and within zones in the constrained period.

Long term allocation of new flexibility capacity

As we stated in our Updated Proposals, we propose that NGG NTS will be obliged to release the equivalent of 22 mcm/day of flexibility capacity in each year of the enduring period. NGG NTS is proposing that all parties including GDNs and direct connects would be able to access exit flexibility capacity in the long term through the national allocation of this level of capacity through a pay as bid auction process. It is assumed that the reserve price will be zero.

In order to manage diversity of DN requirements, NGG NTS is proposing a zonal approach whereby the 22 mcm/day of national flexibility available would be allocated to those that valued it the most, subject to certain specified constraints in the form of 17 zonal maxima and 4 regional maxima.

NGG NTS has indicated that it would not expect, in general, to invest for flexibility as a separate product, but if the signals generated by the pay as bid auctions

were significant it would consider bringing investment proposals forward to Ofgem at the relevant time.

Short term flexibility capacity allocation

Under the short term flexibility allocation process, NGG NTS would accept users' Individual Offtake Profile Notifications (IOPNs) based upon an assessment of capability relative to IOPN submission implied flexibility utilisations and users' longer term holdings.

If the IOPNs are still rejected following re-submission then an auction is invoked and users will have to buy flexibility via a "pay as bid" auction with a zero reserve price. It is also assumed that a flexibility commodity charge would apply in respect of the amount of flexibility used for a gas day.

The proposed non-obligated incremental capacity incentive will encourage the release of flexibility capacity at the day ahead stage by NGG NTS.

Flexibility capacity over-runs

Charges are assumed to apply where there is an aggregate over-run following comparison of the aggregate flexibility flows on a given day with the aggregate capacity rights held in that NTS exit zone. Each user's over-run charge is then determined on the basis of each user's individual over-run with the user's NTS exit flexibility capacity overrun amount multiplied by the highest of:

- 8 times the highest price paid by users at the NTS exit zone NGG NTS for any class of firm NTS exit flexibility capacity for that day;
- 8 times the highest reserve price at the NTS exit zone for any NTS exit flexibility capacity auctions; and
- 1.1 times the highest price paid by NGG NTS for NTS exit flexibility capacity at the relevant NTS exit zone for that day for capacity buy back through any constraint management action.

Flexibility trading / transfers

NGG NTS has proposed that a user will be able to transfer flexibility capacity within the constrained period to:

- another user at a different NTS exit zone, on or before 12.00 ahead of the gas day, subject to the specified area and zonal maxima; and
- another user at the same NTS exit zone or itself, on or before 04.00 on the gas day.

Variations proposed by alternative modification proposals (0116B and 0116C)

Modification proposal 0116B proposes the following modifications to Modification Proposal 0116:

- an increase in the tolerance associated with the flexibility product from 1.5% to 3% to lessen the likelihood of users incurring NTS exit flexibility capacity over-run charges;
- amendment of the detailed rules for when a user may surrender or reduce its NTS exit flexibility capacity holding by submitting or revising an OPN such that any re-submission of an OPN in such a situation reduces the NTS exit flexibility capacity held where it was acquired through the daily release process;
- reference to an NTS exit flexibility commodity charge has been deleted;
- amendment of the rules for exit flexibility capacity over-run charges such that they are only incurred on a "flexible constraint day";
- that exit flexibility over-run charges are not incurred as a result of an inter-trip or forced outage; and
- the NTS exit capacity neutrality arrangements proposed have been split into two parts for flat and flexibility capacity respectively.

Modification Proposal 0116B also proposes that NGG NTS should publish details of any NTS exit flexibility over-run quantities and charges that arise in each zone for each gas day, published on the following gas day.

Modification Proposals 0116B and 0116C propose that NGG NTS should publish the following additional information:

- the actual utilisation of NTS exit flexibility capacity in each zone for each gas day, published on the following gas day; and
- the sum of NTS exit flexibility expected to be utilised in each zone based upon accepted OPNs within 1 hour of OPN submission.

Modification Proposal 0116C proposes the removal of the requirement for users to acquire NTS exit flow flexibility beyond that already existing in the UNC. As such, TCC shippers would continue to acquire a bundled NTS exit capacity product, and only GDNs would acquire separate flat and flexibility products. Provision has also been made for NGG NTS to reject and require resubmission of nominations where it is believed that system flexibility requirements will exceed thecapability of the system and the integrity of the system may be prejudiced.

We would welcome any views from respondents on the extent to which these amendments could affect the costs incurred (with quantification where possible). However, we would note that the impact of charge changes on the level of charges paid by individual users is not the subject of this cost assessment per se as it does not imply costs for the generality of customers given the assumption that the proposals will not affect the totality of revenues recovered by NGG NTS from its users.

Exit capacity management tools

In addition to the interruption of flat capacity or the buy-back of flat or flexibility, NGG NTS have proposed the following exit capacity management tools as follows:

- **exit capacity management agreements.** This may comprise of forward agreements or option agreements. NGG NTS may at any time issue a tender for the buy-back of NTS exit flat capacity at an NTS exit point and NTS exit flexibility capacity at an NTS exit zone. To the extent that NGG

NTS considers that it would be efficient and economic to accept these offers they will be accepted and the associated payments made.

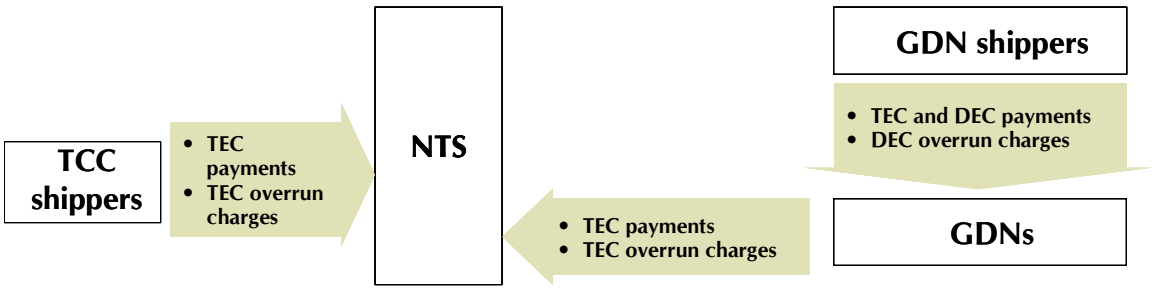
- **within day flow reductions.** NGG NTS may invite users to make offers for the reduction of a specified amount of flow in an NTS exit zone over a specified period within the gas day. Such offers may be made and will be allocated in a similar manner as for capacity buy-back offers (as described above).

Payment flows

It is assumed that, from 1 October 2010, GDNs will have a central role in the payments process, effectively acting as an intermediary for all NTS-related payments from GDN shippers who convey gas to customers offtaking from the GDNs. As such, payment flows would be simplified, minimising the number of payment interfaces between shippers and network owners as GDN shippers would only need to make payments to the relevant GDN, rather than the relevant GDN and NGG NTS.

The payment flows under such an approach are illustrated below in Figure 2.

Figure 2: Proposed enduring payment flows



Key: TEC: Transmission Exit Capacity, DEC: Distribution Exit Capacity

As shown in Figure 2, both GDNs and TCC shippers would pay NGG NTS directly for their requested level of NTS exit capacity, as at present. GDN shippers would not make any payments directly to NGG NTS, but rather the relevant GDN would recover transmission flat and flexibility exit capacity charges from shippers on its network.

We believe that implementation of the proposed payment flows process could reduce costs for GDN shippers by reducing their workload (due to the reduced payment interfaces) and allowing rationalisation of credit arrangements.

Implications for industry participants

NGG NTS

For the purposes of the cost pro forma, we wish to gain an understanding of the extent to which the costs of administering the arrangements will increase or decrease.

On the one hand, we would note that greater consistency in the information received, for example, by moving towards common product definitions, could reduce data processing and administrative costs.

Furthermore, it is our initial view that the costs associated with the long term allocation process may be reduced as a result of common processes and procedures being applied to all NTS users at the same time and a reduced need for the bilateral negotiation of ARCAs.

We acknowledge that the costs of administering medium / short term capacity allocations may increase as the arrangements will be more complex, but would note that the similarity of offtake proposals with arrangements at entry may generate economies of scope of managing the two processes in parallel.

We would note that the following costs should be excluded from the NGG NTS submission:

- any costs incurred by the Agency as a result of the proposals (these costs will be considered separately to costs incurred by NGG NTS);
- any costs associated with the implementation of processes or arrangements that are necessary for compliance with the requirements of the EU Regulation, even if part of the high-level proposals outlined above; and
- any costs incurred as a result of implementing systems or process changes resulting from the current review of charges, which it is assumed would be occurring in any event, absent wider reform.

GDNs

For GDNs, the detailed proposals would have the following implications:

- unlike at present, if a GDN wishes to retain its existing flat capacity rights, then it will not be necessary for the GDN to be proactive, as existing capacity rights will get rolled over by default – representing a potential reduction in workload;

- however, it will be necessary to provide a rolling financial commitment of 14 months;

- if a GDN wishes to increase its flat capacity holdings in the long term, it will be necessary to provide a sustained commitment of 4 years from gas year Y + 4 onwards rather than enter into an ARCA. As such, the administrative burden placed upon the GDN in terms of negotiation and legal costs may be reduced and there would be greater certainty of the financial commitment required to secure capacity;

- in the medium / short term, GDNs will be able to participate in pay as bid auctions to secure flat capacity. For flexibility capacity, GDNs will access such capacity through OPN submission or, in the case of a constraint, through a pay as bid auction. In the event that demand for capacity

exceeds supply, the rules for the allocation of such capacity will be clear and transparent; and

- GDNs will become the intermediary for payment flows, recovering transmission (as well as distribution) exit capacity charges from GDN shippers.

We note that under both the transitional and the enduring regimes, GDNs will be subject to commercial incentives with regard to the level of booking of NTS exit capacity, and that under both regimes, GDNs will be subject to a "1 in 20" licence obligation.

We would note that the following costs should be excluded from GDN submissions:

- any costs incurred by the Agency as a result of the proposals (these costs will be considered separately to costs incurred by GDNs);
- any costs incurred as a result of implementing systems or process changes, which it is assumed would be occurring in any event, absent wider NTS offtake reform; and
- any costs associated with GDN interruption reform.

GDN shippers

GDN shippers will be unaffected by our proposals, other than in relation to the proposed change in payment flows. We believe that implementation of the proposed payment flows process (whereby GDN shippers make payments to only one entity for transportation charges) could reduce costs for GDN shippers by reducing their workload and allowing rationalisation of credit arrangements.

Customers connected to the GDNs

It is assumed that the enduring offtake proposals will have no impact on customers directly connected to the GDNs. Instead, GDN connectees will solely be responsible for booking a level of GDN exit capacity sufficient for their requirements through the current GDN exit capacity booking process via shippers.

The Agency

It is our initial view that the costs associated with the long term allocation process may be reduced as a result of common processes and procedures being applied to all NTS users at the same time.

We acknowledge that the costs of administering medium / short term capacity allocations may increase as the arrangements will be more complex, but would note that the similarity of offtake proposals with arrangements at entry may generate economies of scope of managing the two processes in parallel.

We would note that the following costs should be excluded from the Agency submission:

- any costs directly incurred by the GTs as a result of the proposals;
- any costs associated with the implementation of processes or arrangements that are necessary for compliance with the requirements of the EU Regulation, even if part of the high-level proposals outlined above; and

- any costs incurred as a result of implementing systems or process changes resulting from the current review of charges, which it is assumed would be occurring in any event, absent wider reform.

TCC shippers

It is proposed that TCC shippers will need to book two separate capacity products for both flat and flexibility capacity.

NTS daily metered (DM) supply points

It is assumed that flat capacity will continue to be allocated on an "evergreen" basis with no renewal process required.

However, if a user wishes to reduce in its "prevailing" level of capacity, then it will be necessary to provide 14 months of notice. Flat capacity is therefore booked by default for the next 14 months at an annual application window and the default booking of prevailing capacity levels would have an associated financial commitment to pay 14 months of capacity charges at the prevailing charge.

We therefore anticipate that the proposed long term allocation mechanism for flat capacity could potentially lead to additional credit costs over and above those currently incurred[8].

If a user wishes to guarantee an increase its flat capacity holdings, then it will be necessary to provide a sustained financial commitment of 4 years from gas year Y + 4 onwards (consistent with investment lead times) rather than enter into an ARCA. As such, the administrative burden placed upon the user in terms of negotiation and legal costs may be reduced and there would be greater certainty of the financial commitment required to secure capacity.

The level of costs associated with the allocation of flexibility capacity will be dependent on whether flexibility is booked by the relevant shipper through the long-term or short-term allocation mechanisms. If users decide to purchase flexibility in the long-term this could potentially lead to additional credit costs resulting from the 'pay as bid auction'[9]. We note that these costs may be largely avoided if users purchase flexibility through the daily OPN process.

We would like to understand, for those shippers operating at storage sites or interconnectors, the extent to which costs could be mitigated by the coordination across shippers through application of the "over-run user" concept outlined by the NGG NTS modification, the appointment of a lead shipper or appointment of an allocation agent with respect to both flat and flexibility capacity.

[8] In estimating any credit costs, application of Ofgem's best practice guidelines should be assumed: *Best practice guidelines for gas and electricity network operator credit cover, conclusions document*, February 2005, 58/05, Ofgem.

[9] In estimating any credit costs, application of Ofgem's best practice guidelines should be assumed: *Best practice guidelines for gas and electricity network operator credit cover, conclusions document*, February 2005, 58/05, Ofgem.

NTS connected system exit points (CSEPs)

It is assumed that, unlike at present, flat capacity will be allocated on an "evergreen" basis with no renewal process required – as such, potentially reducing the administration costs for NTS CSEPs in this regard.

However, a rolling financial commitment to 14 months of capacity will be required and therefore may potentially lead to additional credit costs over and above those currently incurred.

If a user wishes to guarantee an increase in its capacity holdings, then it will be necessary to provide a sustained financial commitment of 4 years from gas year Y + 4 onwards (consistent with investment lead times) rather than enter into an ARCA. As such, the administrative burden placed upon the user in terms of negotiation and legal costs may be reduced and there would be greater certainty of the financial commitment required to secure capacity.

The level of costs associated with the allocation of flexibility capacity will be dependent on whether flexibility is booked through the long-term or short-term allocation mechanisms. If users decide to purchase flexibility in the long-term this could potentially lead to additional credit costs resulting from the 'pay as bid auction'[10]. We note that these costs may be largely avoided if users purchase flexibility through the daily OPN process.

NTS interconnectors

It is assumed that, unlike at present, flat capacity will be allocated on an "evergreen" basis with no renewal process required – as such, potentially reducing the administration costs for shippers at NTS interconnectors in this regard.

However, a rolling financial commitment to 14 months of capacity will be required and therefore may potentially lead to additional credit costs over and above those currently incurred.

If a user wishes to guarantee an increase in its capacity holdings, then it will be necessary to provide a sustained financial commitment of 4 years from gas year Y + 4 onwards (consistent with investment lead times) rather than enter into an ARCA. As such, the administrative burden placed upon the user in terms of negotiation and legal costs may be reduced and there would be greater certainty of the financial commitment required to secure capacity.

The level of costs associated with the allocation of flexibility capacity will be dependent on whether flexibility is being booked through the long-term or short-term allocation mechanisms. If users decide to purchase flexibility in the long-term this could potentially lead to additional credit costs resulting from the 'pay as bid auction'[11]. We note that these costs may be largely avoided if users purchase flexibility through the daily OPN process.

[10] In estimating any credit costs, application of Ofgem's best practice guidelines should be assumed*: Best practice guidelines for gas and electricity network operator credit cover, conclusions document*, February 2005, 58/05, Ofgem.

[11] In estimating any credit costs, application of Ofgem's best practice guidelines should be assumed: *Best practice guidelines for gas and electricity network operator credit cover, conclusions document*, February 2005, 58/05, Ofgem.

We also request that respondents who ship gas through the interconnectors should indicate separately in their cost submissions the costs that they forecast would be incurred by their businesses both:

- in the event that a single party (for example, BGN at Moffat) has the responsibility of securing NTS exit capacity at the NTS / interconnector interface in the long term[12]; and
- in the absence of any such arrangements[13].

Storage operators / interruptible sites

It is assumed that sites that are currently interruptible will be allocated their historical SOQ to determine their initial "prevailing rights" to flat capacity – such users will then have the following choices:

- to give notice that they wish to reduce their prevailing rights or to provide a financial commitment (of 14 months) for long term flat capacity;
- sites which choose to give notice to reduce their prevailing rights would:
  - buy firm flat capacity through the annual allocation process, to the extent that it is available;
  - buy firm flat capacity through the day ahead or on the day allocations, to the extent that it is available; or
  - buy interruptible flat capacity through day ahead allocations, to the extent that it is available.

We would like to understand the additional costs that would be incurred if storage operators with two or more shipper customers provided coordination on behalf of its shipper customers through application of the "over-run user" concept outlined by the NGG NTS modification or a lead shipper concept with respect to both flat and flexibility capacity.

It is acknowledged that the arrangements proposed may lead to a change to the level of charges paid by sites that currently have interruptible status. However, we would note that the impact of charge changes is not the subject of this cost assessment per se as it does not imply costs for the generality of customers given the assumption that the proposals will not affect the totality of revenues recovered by NGG NTS from its users.

TCCs

As at present, it is assumed that it would be possible for non-UNC parties, such as TCCs or developers to enter into "reservation agreements" whereby the party would commit to pay the NTS Exit Capacity charges for each year required by the sustained demand test (4 years) for the reserved capacity in the event that all or part of that reserved amount is not booked by its nominated shipper(s) and NGG

[12] Consistent with either Options A or B as outlined in the consultation issued by the Commission for Energy Regulation on 20 October 2006: *CER, Implications for Ireland of Planned Reforms of UK Gas Transmission Exit Regime*, CER/06/222

[13] Consistent with either Option C as outlined in the consultation issued by the Commission for Energy Regulation on 20 October 2006: *CER, Implications for Ireland of Planned Reforms of UK Gas Transmission Exit Regime*, CER/06/222.

NTS would allow the nominated shipper(s) to register the “reserved” capacity for each of the 4 years at any time up to the annual auction ahead of the gas year.