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All interested parties and stakeholders

### **Consultation on changes needed to implement new arrangements for incremental gas transmission capacity (PARCAs)**

If we were to approve National Grid Gas Transmission's (NGGT's) proposed changes to the industry code (UNC) for Planning and Advanced Reservation of Capacity Agreements (PARCA), we would need to make related policy and licence changes for them to work. We are seeking your views on those potential changes.

Some of the changes affect the financial conditions in NGGT's gas transporter licence by:

- adding the phase<sup>1</sup> one PARCA fee to the list of excluded services;
- allowing NGGT to recover phase two costs associated with the PARCA process, but not in all circumstances.

Other changes would:

- set delivery lead times for incremental capacity reserved under PARCAs;
- place obligations on NGGT to inform stakeholders (including us) before signing a PARCA with an NTS user; and
- insert definitions to reflect the new PARCA process.

We<sup>2</sup> have included draft licence text in Annex 1 to show these changes. All tracked changes in this Annex relate to this consultation.

Your views will help us decide what changes we should make to some terms in NGGT's licence. They will also help us finalise the licence text for the statutory consultation processes that may follow later this year. Please send your responses to the questions in this letter to [james.thomson@ofgem.gov.uk](mailto:james.thomson@ofgem.gov.uk) no later than 1 October 2014.

### **The PARCA modifications**

If approved, PARCAs will allow users to reserve incremental capacity<sup>3</sup> through a bilateral process with NGGT rather than the current capacity application windows. They have been developed by NGGT and industry since the start of the RIIO-T1 price control period.<sup>4</sup> NGGT had proposed changes before this, but not in time for our price control final proposals.

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<sup>1</sup> The proposals have three phases. Phase one assesses the capacity request, phase two is about planning.

<sup>2</sup> The terms 'the Authority', 'Ofgem' and 'we' are used interchangeably. Ofgem is the Office of the Gas and Electricity Markets Authority.

<sup>3</sup> PARCAs apply to funded incremental capacity. NGGT will still be able to release non-obligated incremental capacity at entry capacity auctions or exit capacity application windows.

<sup>4</sup> The RIIO-T1 price control period started on 1 April 2013.

Two competing UNC modification proposals, UNC 452V and UNC 465V, have been submitted to us<sup>5</sup>. We will publish our decision on these UNC modifications later this year. We are not consulting on their content in this consultation as industry has already done so.

NGGT will also need to revise several capacity release methodologies once there is greater certainty about the changes we will make, and the revised licence text.

## **The PARCA proposals**

We have summarised the PARCA process below. During the UNC consultation process NGGT published a 'business case' document<sup>6</sup> which describes the PARCA proposals in full. This document is available on the Joint Office of Gas Transporters website and we encourage respondents to read it if they want more information.

The PARCA proposals will establish a new mechanism for NTS users to secure incremental entry or exit capacity. Currently, incremental capacity is either bought at the Quarterly System Entry Capacity auction, the Exit Capacity Application Windows, or by signing an Advanced Reservation of Capacity Agreement. PARCAs will remove the sale of incremental capacity from the capacity allocation processes. Instead, NTS users who need incremental capacity will request it directly from NGGT.

This request will trigger a three-stage process, which will eventually lead to allocating incremental capacity. In phase one, NGGT will assess whether to deliver the incremental capacity through substitution or new network investment. If NGGT and the NTS user both agree on how the capacity request will be delivered they may sign a PARCA.<sup>7</sup>

Phase two covers work by both parties to secure planning approval. If this is granted, NGGT will also undertake construction work to deliver the capacity in phase three. Implementing PARCAs will also require changes to current capacity charging arrangements. At present, NTS users take on the user commitment after they have signalled for incremental capacity and passed the relevant economic tests. Under PARCAs NTS users will not take on this user commitment until after planning permission for all necessary reinforcement work has been granted and the capacity is allocated to them.

A new charge will also be implemented to cover the initial application costs of phase one of the PARCA process. The NTS user requesting incremental capacity will be liable to pay all of this charge.<sup>8</sup> The user will also need to put in place security to underwrite the planning and consents activities should a PARCA be terminated in certain circumstances. UNC 452V and UNC 465V propose different methodologies for calculating the security amount.

## **Our proposed changes**

In order for the PARCA UNC changes to have effect, we think changes are required to the following conditions:

- Special Condition 1A. Definitions
- Special Condition 2A. Restriction of NTS TO Revenue
- Special Condition 5F. Determination of Incremental Obligated Entry Capacity volumes and the appropriate revenue drivers to apply
- Special Condition 5G. Determination of Incremental Obligated Exit Capacity volumes and the appropriate revenue drivers to apply
- Special Condition 11C. Services treated as Excluded Services

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<sup>5</sup> The UNC Modification Panel recommended implementing both UNC 452V and UNC 465V in December 2013 with a majority of Panel members preferring UNC 452V. A copy of the meeting minutes and final modification reports can be found on the Joint Office of Gas Transporters website: <http://www.gasgovernance.co.uk>

<sup>6</sup> The document is called 'Planning and Advanced Reservation of Capacity (PARCA) Overview'.

<sup>7</sup> NTS users can approach NGGT with capacity applications, so it can sign PARCAs with multiple parties.

<sup>8</sup> NGGT estimates the charge will be around £140,000.

## Special Condition 1A: Definitions

We will need to add some new capacity terms and definitions to the licence. Much of the PARCA capacity allocation process will be outlined in the UNC, and we think it's sensible to link the licence definitions to those in the UNC. This should ensure any future changes to the UNC arrangements are automatically reflected in the licence. So we think these terms listed should have the same definitions as those given in the UNC<sup>9</sup>:

- PARCA
- PARCA Applicant
- Phase 1 PARCA Works Report
- PARCA Termination Amount

There are other new PARCA terms that need to be defined in the licence. These terms relate to processes we want to regulate on behalf of consumers, such as capacity delivery times and costs that will be recovered from users. These new definitions are in Annex 1. They are:

- entry and exit capacity lead times definitions, which have the effect of requiring that NGGT must deliver incremental capacity 24 months after the capacity has been allocated to the user; and
- the 'PARCA termination value' definition, to allow NGGT to pass through the outstanding balance of its PARCA termination costs to users, in defined circumstances.

**Question 1:** *Do you agree with the intended drafting of each new licence definition?*

## Special Condition 2A: Restricting NTS TO revenue

We propose changing Special Condition 2A to allow NGGT to collect PARCA termination costs as Maximum Transmission Owner (TO) allowed revenue. Stakeholders have debated the circumstances in which NGGT should be reimbursed these costs. We want to protect industry and consumers from the unnecessary pass-through of termination costs. To do this, we will allow NGGT only to pass through termination costs if it is entitled to access the PARCA security amount provided by NTS users in phase 2.

NTS users who sign a PARCA with NGGT must provide financial security before planning begins in phase two of the PARCA process. The two UNC modifications submitted propose different formulae for calculating this. It will be held in escrow and will reimburse NGGT if a PARCA application is terminated during the second stage of the PARCA process.

The security will be returned to the NTS user if planning consent is granted, and both parties agree to proceed to phase three. NGGT will then allocate the incremental capacity and the NTS user will make a financial commitment. If the planning application is rejected, the security amount will be collected by NGGT or returned to the user as per the contract. The licence changes do not allow any phase two costs to be passed to customers if NGGT is not entitled to collect the security amount.

Terminating a PARCA is a contractual matter between NGGT and the NTS user. If both parties agree, and NGGT collects the security, it will deduct it from the costs incurred during the planning and consents process. It will pass any remaining balance to all NTS users. So if NGGT's costs are less than termination amount, the balance will be deducted from TO allowed revenues and reduce the overall network charges. If NGGT's costs are greater than the termination amount, the outstanding balance will be added to TO allowed revenues and collected from all NTS users through increased network charges. The draft licence text in Annex 1 would implement this policy by subtracting aggregate security

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<sup>9</sup> The exact UNC definitions are in both UNC modifications submitted to us in December 2013

amounts collected by NGGT from the costs incurred associated with the terminated PARCAs to calculate the termination value. The formula makes a number of adjustments to take account of tax, spending in previous years and inflation effects.

The text says that a PARCA termination value will be zero if NGGT is not entitled to recover the PARCA security. This prevents NGGT passing through its phase two costs to users if the user is entitled to reclaim the security. So if termination occurs because NGGT has not met a term of the contract, all NGGT's phase two costs are borne by NGGT not users.

Please note that this draft text could change. Calculations with this complexity might better sit within the Price Control Financial Model (PCFM) than the licence itself. This approach could allow for more straightforward handling of costs should PARCAs be terminated. We are considering this issue and will conclude before the statutory licence consultation. We are consulting on this text now because we want to know your views on the policy as set out in the formula, before deciding where the final formula should sit.

**Question 2:** *Do you agree with the proposals to adjust collected revenues to include PARCA termination amounts, but not in all circumstances?*

### **Special Condition 5F: Determining incremental obligated entry capacity volumes and the revenue drivers**

We are proposing to add new text to Special Condition 5F, to make NGGT notify stakeholders when a PARCA is signed. We also want to remove out-of-date text referring to revenues before the introduction of the Generic Revenue Driver Methodology (GRDM) Statement. Introducing PARCAs may lengthen the process of allocating incremental capacity. It could take up to seven years between an NTS user signing a PARCA and being allocated the capacity. So there is a period of uncertainty before our final decision whether to approve capacity allocation or substitution. We think it is right for us to approve allocating or substituting capacity only after the NTS user is ready to take on firm user commitment. This will make sure we don't approve releasing capacity which is not needed if a PARCA is terminated. It also guards against the possibility of NTS users being allocated capacity before they can make a user commitment. We are not amending the licence drafting about us approving NGGT's request for final capacity allocation and substitution.

A new Part A in Special Condition 5F will require NGGT to publish a notice towards the end of phase one.<sup>10</sup> This will tell stakeholders that a PARCA has been requested, how much capacity, which NTS points are affected, and how NGGT will deliver it. NGGT is responsible for making stakeholders aware this notice has been published. The notice does not create an obligation to approve the proposed PARCA. It will, however, make stakeholders aware earlier that a PARCA is being progressed, so they can consider NGGT's proposals for delivering the requested capacity.

We propose removing paragraph 5F.10(h) as it refers to permits arrangements that will be superseded by PARCAs. We also want to delete existing Parts C, D and E in this special condition. These parts refer to totex allowance arrangements if the GRDM is not in place. We approved the GRDM statement on 23 October 2013, so the text can be removed.

**Question 3:** *Do you agree with the text which adds a new 'Part A' to Special Condition 5F?*

### **Special Condition 5G. Determining incremental obligated exit capacity volumes and revenue drivers**

We are proposing changes to Special Condition 5G similar to those proposed to Special Condition 5F. This includes adding a new Part A which requires NGGT to publish a notice saying it intends to reserve incremental capacity for a PARCA. Our reasons for these changes are the same as for Special Condition 5F.

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<sup>10</sup> This is in addition to, and separate from, UNC obligations for NGGT to operate PARCA windows.

We also propose to delete paragraph 5G.10(h) which refers to permit arrangements that will be superseded by PARCAs. We will delete existing Parts C and D which refer to totex arrangements if a GRDM statement is not in place. As we approved the GRDM statement in 2013, we think this text can be deleted from the licence.

**Question 4:** *Do you agree with the text which adds a new 'Part A' to Special Condition 5G?*

### **Special Condition 11C: Services treated as Excluded Services**

Special Condition 11C lists excluded services. These services are not funded through base revenues. NGGT proposes that the phase one PARCA fee should be treated as an excluded service, so that the user triggering a PARCA process should be wholly liable to pay it. Phase one covers the initial application to assess how the request can be met. PARCA applicants will pay a fee which will be reconciled against actual costs incurred by NGGT after phase one is complete. NGGT estimates that this fee will on average be around £140,000.

We agree that the user triggering the process should fund the phase one costs, rather than these costs being socialised. We are proposing adding text to Special Condition 11C to include phase one of the PARCA process as an excluded service.

**Question 5:** *Do you agree with adding phase one as an excluded service?*

**Question 6:** *Do you agree with the wording in Special Condition 11C?*

**Question 7:** *Do you agree that the financial, lead time and stakeholder notification policy changes should be implemented to allow the introduction of PARCAs?*

### **Other licence changes we are consulting on separately**

We are separately proposing changes to Special Condition 1A and 5F to facilitate the implementation of the Capacity Allocation Mechanism (CAM) Network Code. The main objective of these changes is to split the current Bacton Aggregated System Entry Point (ASEP) into two new system entry points. A copy of the consultation containing these proposals can be found on our website.<sup>11</sup>

There are no direct policy interactions between the changes proposed in this consultation and the CAM proposals. We are therefore running the two separate consultations in parallel. The CAM proposals contain draft licence text which shows the effect of splitting the Bacton ASEP on Special Condition 5F.<sup>12</sup> As we are still consulting on the CAM proposals, we have not shown their effect in the draft licence text accompanying this consultation. The final changes to these Special Conditions will depend on the outcome of the two consultations.

### **Responding**

If you wish to respond to this consultation, please email [james.thomson@ofgem.gov.uk](mailto:james.thomson@ofgem.gov.uk) by 1 October 2014. You can also speak to James on 0141 331 6012 if you need more information. We will consider and publish a summary of responses on our website after the consultation ends. Please mark your response as confidential if you don't want it published.

Yours faithfully,

### **Andy Burgess**

Associate Partner: Transmission and Distribution Policy

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<sup>11</sup> 'Facilitating the implementation of aspects of the Capacity Allocation Mechanisms Network Code in Great Britain: <https://www.ofgem.gov.uk/publications-and-updates/facilitating-implementation-aspects-capacity-allocation-mechanisms-network-code-great-britain>

<sup>12</sup> In respect of Special Condition 1A, the CAM proposals are in respect of an amendment to the definition of Off-peak Exit Capacity. We therefore do not think that there is any interaction with that proposed amendment and those contained in this consultation.