

NGGT, NTS users, interested
parties and stakeholders

Direct Dial: 020 7901 7159
Email: andrew.burgess@ofgem.gov.uk

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Proposed licence modification of Special Licence Conditions 1A, 2A, 5F, 5G and 11C of National Grid Gas Transmission's Licence to implement Planning and Advanced Reservation of Capacity Agreements

We¹ would like to make changes to National Grid Gas Transmission's (NGGT's) licence to enable the introduction of Planning and Advanced Reservation of Capacity Agreements (PARCAs). We consulted on proposals in August², and we are now seeking views on the drafting of the changes we want to make.

This is a statutory consultation on our proposed modifications. These are set out in annex A in the modification notice (under section 23 of the Gas Act 1986) which accompanies this document.

Summary

PARCAs are a new process for users to access incremental gas transmission capacity, taking account of the likely planning and construction timescales. On 6 August 2014 we published a consultation setting out our proposed policy and proposed changes to the special conditions of NGGT's licence to allow NGGT to introduce PARCAs. This consultation closed on 1 October. Respondents generally supported our proposals, but gave feedback regarding particular details of the proposed policy.

Following detailed consideration of the points raised in the responses we are proceeding to statutory consultation on changes to NGGT's licence associated with the introduction of PARCAs.

The following sections summarise our proposals to do the following (as set out in detail in the August consultation document):

- add new licence definitions to reflect the PARCA arrangements
- require NGGT to inform stakeholders about PARCA agreements
- outline how PARCA termination costs will be treated as part of transmission owner (TO) allowed revenue
- remove out of date licence text
- include the phase one PARCA fee as an excluded service.

² <https://www.ofgem.gov.uk/publications-and-updates/consultation-changes-needed-implement-new-arrangements-incremental-gas-transmission-capacity-parcas>

We have explained any changes to our proposals below.

As set out in our August consultation, NGGT proposes PARCAs as a mechanism to release incremental National Transmission System (NTS) capacity³ to NTS users. If introduced, PARCAs will replace the sale of incremental capacity at the Quarterly System Entry Capacity (QSEC) auction and Exit Capacity July application window.⁴

The proposed PARCA process will contain a maximum of three stages.

- In stage one, NGGT will undertake preliminary analysis of how the request for incremental capacity can be delivered. This includes options to use or substitute unsold existing capacity.
- If stage one is successfully completed and reinforcement work is required, NGGT and the NTS user will undertake planning and consenting activities in stage two.
- If planning permission is granted at stage two, NGGT will build and deliver the capacity in stage three.

PARCAs require a mix of new funding and capacity release changes. In order to introduce the proposed arrangements a number of changes would be required to the special conditions of NGGT's gas transporter licence, to the Uniform Network Code (UNC) and to the gas capacity methodology statements.

We consulted on draft licence text in our initial consultation published on 6 August 2014. This consultation outlined the changes we think are needed for NGGT:

- to collect the phase one PARCA fee
- to pass through the outstanding balance of PARCA termination costs to the TO allowed revenues
- to notify stakeholders when a PARCA agreement is signed.

We also set out other changes to remove out of date licence text.

We asked for comments on the proposed policy changes as we wanted to seek views from a wider range of stakeholders than those who had been involved in the UNC modification process.

Two competing UNC modifications were submitted to us in December 2013⁵. Both modifications propose almost identical changes to the UNC with the exception of how the security amount to support phase two of the PARCA process will be calculated. We will make a decision on which, if any, of the UNC modifications to implement after we have received responses to this consultation.

Depending on responses, we hope to publish our decision the licence changes, and on the UNC modifications, before the end of this calendar year.

NGGT will revise several gas capacity methodology statements once there is greater certainty about the relevant licence text.

Respondents should note that we consulted in June 2014 on changes to Special Condition 1A and 5F of NGGT's licence to facilitate the implementation of the Capacity Allocation Mechanism (CAM) Network Code.⁶ The main objective of these changes is to split the Bacton Aggregated System Entry Point into two new virtual entry points.

³ Funded incremental capacity

⁴ Developers can also agree the release on incremental exit capacity by signing an Advanced Reservation of Capacity Agreement with NGGT

⁵ A copy of the modifications can be found on the Joint Office website: www.gasgovernance.co.uk

⁶ <https://www.ofgem.gov.uk/publications-and-updates/facilitating-implementation-aspects-capacity-allocation-mechanisms-network-code-great-britain>

There is no direct policy interactions between the changes proposed in this consultation and the proposals designed to facilitate the implementation of the CAM Network Code. However, respondents should be aware of the changes we propose to make in order to facilitate the implementation of the CAM Network Code as this will affect the numbering and cross referencing within both special conditions.

Overview of consultation responses and our views

We received seven responses to the August 2014 consultation, none of which were marked confidential. All have been published on the Ofgem website.⁷ In general, responses were positive and most stakeholders supported both the PARCA policy intent and how it would have effect. There was broad support for the proposed text for the modification of the special licence conditions of NGGT's licence. Several respondents suggested that it was difficult to comment on the proposed text for the modification of NGGT's special licence conditions without seeing corresponding changes to the gas capacity release methodology statements.

However, respondents raised a number of concerns with the proposed text for the modification of NGGT's special licence conditions. We set these out, along with our views on them, below.

Entry and exit capacity lead times

We are proposing to introduce a new requirement to ensure that capacity is delivered by NGGT within a 24 month period.

Respondents welcomed our proposal to change the entry and exit capacity lead time definitions set out in Special Condition 1A of NGGT's licence which are designed to ensure that capacity is delivered within a 24 month time period.⁸ One respondent said that this would allow projects to follow customer timescales rather an arbitrary October delivery date.⁹

Several respondents sought assurances that where NGGT is able to deliver capacity earlier than 24 months it would be able to do so under the new proposed licence text.

One respondent suggested the definitions may mean there is no guarantee of a complete two season build calendar. This could increase the risk that capacity cannot be delivered on time. It asked lead times to be reviewed once there is more experience of taking projects through the PARCA process.

Our views

Throughout the development of the PARCA arrangements, NGGT was clear that it would only require a maximum two year time period to deliver additional NTS infrastructure. The revised entry and exit lead time definitions included in the proposed text of Special Condition 1A were intended to implement that 24 month time period.

We do not consider the definitions would prevent NGGT from delivering capacity ahead of a 24 month timescale if this is possible.

We are also content for NGGT or other parties to suggest changes to the lead times after there is more experience of taking projects through the PARCA process. Any request to change the definitions set out in Special Condition 1A would need to be based on a

⁷ <https://www.ofgem.gov.uk/publications-and-updates/consultation-changes-needed-implement-new-arrangements-incremental-gas-transmission-capacity-parcas>

⁸ 24 months from the month after the allocation is agreed.

⁹ The previous lead time definitions release capacity from 1 October.

comprehensive analysis of actual PARCA proposals and demonstrate that different lead times would be more suitable.

Addition of phase one PARCA fee

Respondents were happy with our proposal to add the phase one PARCA fee to the list of excluded services in Special Condition 11C of NGGT's licence.

One respondent noted that gas distribution networks (GDNs) requiring incremental capacity due to general demand growth would not be able to pass this fee onto a specific distribution network customer. The respondent said this highlights flaws in the capacity regime which treats GDNs in the same manner as direct connect customers.

Our views

We are proposing to add the phase one PARCA fee as an excluded service in Special Condition 11C.

We note the concern about the pass through of this fee to GDN customers when incremental capacity has been requested due to general distribution network demand growth. However, we don't think this can be addressed through changes to the gas transmission licence text we are consulting on.

It is more likely this issue can be addressed through considering changes to the capacity obligations agreed in the gas distribution price control. We have discussed this point with the respondent. We are happy to continue to engage with other stakeholders who may have similar concerns to understand how a solution could be put in place.

Proposed changes to Special Conditions 5F and 5G of NGGT's licence

There was support for our proposal to include new provisions in Special Conditions 5F and 5G obligating NGGT to inform stakeholders that a PARCA has been requested and how NGGT intends to meet the incremental capacity demand.

One respondent, while stating it supported new proposed transparency provisions, said the proposed licence text drafting would not implement the intended changes. It thought the licence text drafting would not require NGGT to publish a notice if it can meet the incremental capacity request entirely through substituted capacity.

Respondents supported removing out of date licence text referring to capacity arrangements before the introduction of the Generic Revenue Driver Methodology Statement.

One respondent suggested that we keep sub paragraphs in Special Conditions 5F.10(h) and 5G.10(h) until there is a clear implementation date for the PARCA arrangements. These sub-paragraphs oblige NGGT to include detailed permit arrangement information in the notice it sends to us requesting the release of incremental capacity.

Our views

We propose to add a new Part A to both Special Conditions 5F and 5G of NGGT's licence. If implemented, this will place an obligation on NGGT to inform stakeholders before a PARCA is signed. We consider this will provide stakeholders, including us, with information on how much capacity has been requested and how NGGT will deliver that capacity. The additional proposed licence text should continue to ensure capacity is transparently allocated to NTS users.

We have reviewed our proposed licence text changes and are confident they will oblige NGGT to publish a notice even if a capacity request is being met entirely through

substitution. The proposed obligation to publish a notice is tied to the request for funded incremental entry or exit capacity.¹⁰ When a capacity request is made, neither the applicant nor NGGT will know if substituting capacity from elsewhere on the NTS is possible. NGGT will determine this during phase one of the PARCA process.

Subsequent text in Part A makes clear that NGGT must also outline how much of the capacity request will be met by Funded Incremental Capacity (ie new NTS infrastructure) and how much by substitution.

We propose to retain sub paragraphs 5F.10(h) and 5G.10(h) of NGGT's special licence conditions which oblige NGGT to include details of permit arrangements when submitting a notice seeking the release of incremental entry or exit capacity. We will consider whether to remove these paragraphs as part of ongoing work to revise the permit arrangements in the gas transporter licence.

We propose to remove the out of date text which refers to capacity arrangements before the introduction of the Generic Revenue Driver Methodology statement.

The timing of our decision on capacity substitution

Five respondents to our August consultation were concerned that we will exercise our powers to veto capacity substitution requests too late in the PARCA process. It is expected that a request to substitute capacity will be made to us when the PARCA applicant is ready to take on user commitment associated with that capacity. This will take place at the beginning of phase three for PARCAs requiring planning approval.

Respondents said that developers might not proceed with NTS projects that require significant investment if there is a possibility we could veto substitution after a planning decision was made. One respondent said:

"We welcome the alignment of both Parties project development timelines, together with phased financial commitment...and agree this should give developers confidence to signal their long term capacity requirements. However, Ofgem's ability to veto substitution at the point of allocation, which could be five years after the original signal was made, completely undermines this."

Several respondents mentioned the timing of the substitution decision in relation to taking part in the Electricity Market Reform capacity market auction. They thought it would be unlikely for owners of new gas-fired generation plant to take part in the capacity market auction if reserved capacity could be subsequently vetoed by us.

Several respondents to the August consultation said we should consider capacity requests earlier in the PARCA process. At the end of phase one, before an NTS user agrees a PARCA with NGGT and the capacity is reserved, was considered to be a suitable time. Respondents said this would give the user greater assurance that the capacity will be available if planning permission is approved.

One respondent suggested that we should outline in what circumstances we would veto capacity substitution. It also requested clarity on what would happen to a PARCA agreement if a proposal to substitute capacity was vetoed.

Our views

We have considered carefully the arguments made in the consultation responses.

Some respondents want us to propose licence text allowing us to approve or veto capacity substitution requests before the PARCA applicant takes on a firm user commitment for that

¹⁰ Paragraphs 5F.3 and 5G.3

capacity. We understand respondents consider this would remove the risk of us vetoing substitution proposals at the end of what could be a long process to secure capacity release.

However, we think decoupling our capacity substitution decision from firm financial commitments being made for capacity would unfairly shift risk onto consumers. This would give certainty over future capacity availability to users who have made no commitment to pay for it. It could also introduce inconsistencies into the capacity release process if a PARCA were terminated, or if the amount of capacity delivered to the applicant was different from that anticipated when we made a decision on capacity substitution.

We understand concerns respondents have expressed about the potential uncertainty this could create for their projects. In our view this is comparable to the risk that will exist for PARCA applicants if planning permission is required to deliver incremental capacity. NTS users will need to proceed with investment projects on the basis that there will be uncertainty around the final decision made by the relevant planning authority. We can see no compelling reason why our decision on capacity substitution would create additional risk that would prevent NTS users continuing with an investment project.

Our current view is that there are likely to be relatively limited circumstances in which we would veto a capacity substitution request, although we will consider each request on its merits. As part of the PARCA process, NGGT will consider the opportunities for capacity substitution in line with the relevant capacity substitution methodology statement. In the normal course of events, we anticipate that we would veto a substitution request where NGGT has failed to correctly apply the methodology.

Our proposed changes requiring NGGT to publish details of PARCA requests will allow NTS users and us to consider and challenge NGGT over capacity substitution at an early stage of the process.

If no challenges are made, and the PARCA does not change substantially as it proceeds through the PARCA process, then it would be unlikely, in the majority of cases, for us to veto the capacity substitution when the applicant is ready to make a firm financial commitment.

Our approach does not change current arrangements. The introduction of the notification stage will improve the transparency of the process and give applicants comfort we are aware of NGGT's proposals.

Pass through of termination costs

Five respondents to the August consultation raised concerns about the proposals allowing the pass through of costs related to terminated PARCAs, in particular, about how these proposals interact with the reasonable endeavours assessment contained in the PARCA contract. The contractual terms outline that if a PARCA is terminated and NGGT is found to have used reasonable endeavours to deliver the capacity, it can collect the PARCA security amount put up by the applicant.

Some respondents are concerned that if the value of this PARCA security amount is low, the applicant may not engage in a 'reasonable endeavours' discussion with NGGT and allow it (NGGT) to collect the security. This may allow NGGT to pass substantial costs through to industry and consumers. For example, one respondent noted:

"If the Termination Amount is low they may simply pay. The implication is costs incurred by National Grid in excess of the Termination Amount would be passed through to allowed revenues and hence paid by all consumers."

Respondents suggest we should outline the circumstances in which NGGT would not be eligible to pass through termination costs. In particular, we should be clear in what

circumstances costs can be passed through if NGGT has been refused planning permission for NTS reinforcement work. Other respondents suggest we should examine NGGT's costs on a case by case basis and make an assessment on whether they have been economically and efficiently incurred.

We noted in our August consultation that the proposed licence text – which consisted of algebra to calculate termination costs – could be moved to the Price Control Financial Model (PCFM). One respondent was concerned moving the text to the PCFM would reduce the transparency of process. It preferred the text to stay within the gas transporter licence.

Another respondent considered excess termination costs should only be socialised where the PARCA applicant has terminated a PARCA agreement.

Our views

We understand concerns expressed by respondents about the potential for inappropriate costs to be passed through to NTS users. This is a particular issue in circumstances where planning permission has been refused and the pass through of costs depends on an assessment of whether NGGT has used reasonable endeavours to secure planning permission.

We still think it is right for any decision as to whether reasonable endeavours have been used in a particular case to be made by NGGT and the PARCA applicant. The PARCA contract contains the provisions for both parties to take forward discussions if planning permission is refused. As both NGGT and the applicant will have appropriate planning and legal resources available to them, in our view they are best placed to make this assessment.

For this reason we do not think we should have any role in assessing whether reasonable endeavours have been used. Any such assessment would require a judgement to be made on the performance of both parties during the planning process. We do not have the sufficient expertise to carry out this assessment. We also have no role to directly intervene in bi-lateral contractual disputes between NGGT and its customers.

However, it is not the case that termination costs NGGT proposes to pass through would not be subject to scrutiny and consultation by us. The decision to pass through termination costs would be made as part of the Annual Iteration Process (AIP). The AIP determines NGGT's base revenues each year calculated in line with the methodologies contained in the gas transporter license special conditions and PCFM handbook.

As part of this process, any termination costs NGGT proposes to pass through would be examined to make sure they have been incurred efficiently and economically, and publicly consulted on. This will provide stakeholders with an opportunity to contact us if they have concerns about the PARCA termination costs NGGT proposes to pass through.

Our August consultation paper contained draft licence text which showed how PARCA termination values will be calculated. We stated we may move these formulas to the PCFM but wanted to provide respondents with the opportunity to see and comment on the intended calculation.

We have decided not to move the formulas and text contained in the initial consultation to the PCFM. We still consider that moving the formulas to the PCFM could offer significant benefits in terms maintaining a clear and transparent gas transporter licence. The formulas could be placed in the PCFM alongside similar algebra required to calculate NGGT's collected allowed revenues.

However, we think our focus should be on proposals allowing the implementation of PARCAs as soon as possible. Moving the text we consulted in the initial consultation to the

PCFM could further delay implementation as we would need to develop and consult on replacement licence text.

We propose to implement the changes to the text of Special Condition 2A as consulted on in the August consultation paper. We do not consider this has any practical effect as the pass through of PARCA termination costs will still be made through the AIP and PCFM outlined above.

It is also highly unlikely a PARCA will be terminated early next year taking into account delivery times for phase one of the PARCA process.

Our proposal to retain the licence text should address the respondent's transparency concern in the short term. However, as the AIP contains an efficiency assessment and is subject to a public consultation we do not currently believe there would be any long term transparency issues in moving the formulas to the PCFM. The PCFM Handbook, which is available to all stakeholders, would also explain the process which will need to be undertaken in order to vary PARCA termination costs. We would consult fully on any future proposal to move the text.

We also note comments about socialising the excess PARCA termination costs recovered by NGGT. Both UNC modification proposals submitted to us propose that the PARCA security amount is based on either the capacity charge at the NTS point where capacity has been requested or that it based on an average of capacity charges. As the security is not linked to the actual costs incurred by NGGT, the proposal is that any excess or shortfall amount that remains is passed through to all NTS users.

We consider this was covered within the UNC process which led up to the submission of the two modifications. The licence text we propose to implement reflects the PARCA arrangements developed and agreed by NGGT and NTS users through various UNC and industry workshops. The de-linking of security from costs incurred through the planning process was discussed at length in these meetings.

We recommend stakeholders seek changes though the UNC arrangements if they remain concerned about the PARCA security amount calculation and how that relates to the recovery of NGGT's planning costs.

Next steps

This statutory consultation on proposed amendments to special conditions of NGGT's licence is for responses on or before 24 November 2014. Once we have considered responses, we aim to make a final decision on whether to implement the reforms by December 2014.

If we decide to implement the reforms, licence holders, trade bodies representing licence holders and Citizens Advice and/or Citizens Advice Scotland will have 20 working days to decide (from the first working day after our decision is published) if they want to appeal against the reforms to the Competition and Markets Authority. Subject to the appeals process, it is intended that the reforms would start to take effect in early 2015.

If we decide to implement the changes to the special conditions of NGGT's licence we propose they would come into effect at the end of the minimum statutory period for implementation. This means NGGT would need to ensure it was compliant with the new arrangements from the date the licence modifications become effective, which we are proposing would be 56 days after the day our decision is published.

Any representations to the proposed licence modifications must be made on or before 21 November 2014 to: James P Thomson, Ofgem, Third Floor, Cornerstone, 107 West Regent Street, Glasgow, G2 2BA or by email to: james.thomson@ofgem.gov.uk

Please note that any responses to the consultation will be placed on Ofgem's website unless marked as confidential. Ofgem prefers to receive responses in an electronic form so they can be placed easily on the Ofgem website. Subject to responses to the statutory consultation and, in the event that the Authority decides to proceed with the modifications, it is intended that the modifications will take effect in early 2015.

If you have any queries regarding the content of this letter please contact James Thomson by using the email above or telephone 0141 331 6012.

Yours faithfully,

Andy Burgess

Associate Partner, Transmission and Distribution Policy