

Modification proposals:	<b>Uniform Network Code (UNC) 452V: Introduction of the Planning and Advanced Reservation of Capacity Agreement (PARCA) and UNC465V: Introduction of the Planning and Advanced Reservation of Capacity Agreement (PARCA), Weighted Average PARCA Security</b>		
Decision:	The Authority <sup>1</sup> directs that UNC 465V be made <sup>2</sup>		
Target audience:	The Joint Office, Parties to the UNC and other interested parties		
Date of publication:	5 December 2014	Implementation Date:	2 February 2015

## Background to the modification proposals

National Grid Gas Transmission (NGGT) has developed the Planning and Advanced Reservation of Capacity Agreement (PARCA) arrangements to allow National Transmission System (NTS) users to secure incremental gas capacity.<sup>3</sup> This is new gas capacity in addition to existing "obligated capacity" NGGT is funded to make available.<sup>4</sup>

PARCAs would align the release of incremental gas capacity to planning processes implemented by the Planning Act 2008.<sup>5</sup> NGGT estimates the Planning Act 2008 has extended the length of time it could take to complete the most complicated incremental capacity projects to between six and eight years. This is much longer than lead times currently defined in NGGT's gas transmission licence<sup>6</sup>.

There are concerns the longer lead times could discourage NTS users from making investments because they may have to commit financially to capacity before the outcome of a potentially lengthy planning process is known.

Modifications UNC452V and UNC465V propose to codify the PARCA arrangements. Both modifications can be considered alternatives to each other as they seek to implement materially the same arrangements into the Uniform Network Code (UNC). The only difference between them is how the PARCA Security Amount is calculated. This amount is required from NTS users to underwrite NGGT's planning activities.

If introduced, the PARCA arrangements would implement a multi-stage process for NTS users to secure incremental gas capacity on the NTS. NTS users will need to enter into a bilateral contract with NGGT if they require incremental capacity. This will place obligations on the parties to reserve incremental capacity and to obtain planning consent before the capacity can be made available to the NTS user. Fees, security and financial commitments would be phased to align with the different stages of the process.

<sup>1</sup> The terms 'the Authority', 'Ofgem' and 'we' are used interchangeably in this document. Ofgem is the Office of the Gas and Electricity Markets Authority.

<sup>2</sup> This document is notice of the reasons for this decision as required by section 38A of the Gas Act 1986.

<sup>3</sup> The proposals relate to funded incremental capacity.

<sup>4</sup> Existing obligated capacity can also be reserved to meet a PARCA application.

<sup>5</sup> As amended by the Localism Act (2011).

<sup>6</sup> NGGT must release incremental entry capacity 42 months from the first month after the auction takes place and incremental exit capacity 36 months after the first day of the next gas year following the date on which the allocation occurred.

Implementing PARCAs would mean NTS users would no longer be able to acquire incremental NTS gas capacity at the Quarterly System Entry Capacity (QSEC) auction or Exit Capacity Application Window.<sup>7</sup>

UNC452V was developed by NGGT to codify the PARCA arrangements. However, after the workgroup report was completed, concerns were raised about the calculation of the PARCA Security Amount required from applicants to allow planning activities to be taken forward.<sup>8</sup> UNC452V proposes this is calculated using the entry or exit capacity charge at the NTS point where capacity has been requested.

Some NTS users, including Scottish and Southern Energy (SSE), preferred security requirements to be based on an average of all NTS entry or exit capacity charges. As it was too late in the modification development process to draft alternative text for UNC452V, SSE instead proposed UNC465V containing different security provisions.

The PARCA Security Amount calculation is the only difference between UNC452V and UNC465V. In this respect the modifications are mutually exclusive. We may approve one modification proposal and reject the other, or reject both modification proposals, but we cannot approve both modification proposals because that would create contradictory UNC provisions.

### **The modification proposals**

A full description of the capacity release process proposed by both modifications can be found in the PARCA overview document published as part of the UNC452V and UNC465V consultations.<sup>9</sup>

Both modifications describe the UNC changes to codify this process. These are summarised below.

#### **UNC Transportation Principal Document (TPD) Section B**

- Defining the PARCA and PARCA application form, and that they can be entered into by NTS users and non-NTS users.
- Introducing the reservation of entry and exit capacity.
- Outlining the process which NTS users will be required to follow to signal for and request incremental capacity, and time limits for specific steps.
- Describing the process and time limits for NGGT to respond to capacity requests.
- Introducing a requirement for NGGT to undertake an ad-hoc QSEC auction if unsold entry capacity can be reserved as part of a PARCA.
- introducing the PARCA window to allow other NTS users to bring forward additional incremental capacity requests.
- Outlining the reports NGGT will produce as part of the phase one assessment.
- Applying demonstration date provisions which NTS users will be required to meet for an incremental capacity request to remain active to entry users.
- Provisions for non UNC (non-code) parties who take forward incremental capacity agreements to nominate UNC users to take delivery of the incremental capacity.

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<sup>7</sup> NGGT will still be able to allocate non-“obligated incremental capacity” at these mechanisms. This capacity is released at NGGT’s discretion and own risk.

<sup>8</sup> The PARCA Security amount only refers to security required during the planning stage of the PARCA process. It does not change the security requirements after capacity has been delivered and allocated to NTS users as outlined in the UNC.

<sup>9</sup> A copy of the PARCA Overview can be found on the UNC 452V modification proposal page on the Joint Office website – <http://www.gasgovernance.co.uk>

- Removing the ARCA process for exit users.

#### **UNC TPD Section Y**

- Describing how the PARCA Phase One Fee is calculated.
- Describing how the PARCA Security Amount is calculated.
- Explaining the equations for the Total PARCA Security Amount for both entry and exit capacity.
- Describing how the PARCA Security Amount is phased.
- Outlining how the PARCA Termination is calculated.

As explained above, the only difference between both modification proposals is how the PARCA Security Amount is calculated.

Both NGGT and SSE believe that their modification proposals will promote the efficient discharge of NGGT's obligations under its licence<sup>10</sup> and effective competition between NTS users.<sup>11</sup> They consider that their respective modifications will further the achievement of connection charging methodology objectives to properly take account of developments in NGGT's transportation business<sup>12</sup> and that NGGT should not show undue preference or discrimination against any person who operates a pipeline system.<sup>13</sup>

NGGT thinks that the security provisions in UNC452V will help to make sure the cost of reserving capacity reflects the value of that capacity. It also considers that the provisions are equitable as they apply the same methodology to calculate security to all NTS users.

SSE consider that the security provisions in UNC465V will, if implemented, create more stable security requirements on PARCA applicants. It argues that as the costs of undertaking planning activities will be broadly similar for projects across the NTS, it would be unfair to base the amount of security on specific NTS charges which vary substantially across the network. This would mean security requirements would be based on the location of the project and lead to significant variability in the amount of security PARCA applicants would be expected to provide.

SSE also thinks UNC465V will align more closely the security required from PARCA applicants to the actual costs incurred by NGGT during the planning process.

#### **UNC Panel<sup>14</sup> recommendation**

The UNC Panel met on 19 December 2013 to vote on whether to recommend the implementation of UNC452V and UNC465V. Ten votes were cast in favour of implementing both modifications. Therefore, the Panel recommended the implementation of both UNC452V and UNC465V.

The Panel then considered which of the two modifications would be expected to better facilitate the achievement of the relevant objectives of the UNC. Seven votes were cast in favour of UNC452V and four votes cast in favour of UNC465V. Therefore, the Panel determined that UNC452V would be expected to better facilitate the achievement of the relevant objectives of the UNC when compared to UNC465V.

<sup>10</sup> Special Condition A 11: Network Code and Uniform Network Code paragraph 1(c).

<sup>11</sup> Special Condition A 11: Network Code and Uniform Network Code paragraph 1(d).

<sup>12</sup> Standard Condition 4B: Connection Charging Methodology paragraph 5(c).

<sup>13</sup> Standard Condition 4B: Connection Charging Methodology paragraph 5(d).

<sup>14</sup> The UNC Panel is established and constituted from time to time pursuant to and in accordance with the UNC Modification Rules.

## **Our decision**

We have considered the issues raised by the modification proposals and the Final Modification Reports (FMR) dated 19 December 2013. We have considered and taken into account the responses to the Joint Office's consultations on the modification proposals which are attached to the FMRs.<sup>15</sup> We have concluded that of the options open to us, implementing UNC465V will best facilitate the achievement of the relevant UNC objectives<sup>16</sup> and further our principal objective to protect the interests of consumers, both future and present.

We have therefore decided:

1. not to implement modification proposal UNC452V; and
2. to direct that modification UNC465V be made.

## **Reasons for our decision**

We believe the arguments for and against the proposed modifications are the same for UNC452V and UNC465V. We have therefore assessed both against the relevant UNC and connection charging methodology objectives and our statutory duties.

We have used the conclusions below to inform our decision.

- Both modifications facilitate the relevant objectives in so far as they will prevent a possible conflict between the capacity release mechanism and the planning process.
- The difference between the modifications is modest. UNC465V will require NTS users to provide more consistent and less variable PARCA Security Amounts than the equivalent proposal in UNC452V. It will be more likely to match the PARCA Security Amount to the actual costs NGGT incur during the planning process.
- On this basis, we think UNC465V will be more cost reflective than UNC452V.

We have decided to approve UNC465V and to reject UNC452V as UNC465V better facilitates the relevant objectives. We provide more information below on our assessment of the modifications against the applicable relevant objectives.

*Standard Special Condition A11 paragraph 1(c): Efficient discharge of the licensee's obligations*

Both UNC452V and UNC465V will continue to allow NGGT to discharge its licence obligations to provide a transparent and accessible incremental capacity allocation mechanism.

NGGT argues that it may not be able to provide incremental capacity in default lead times if the allocation arrangements are not changed. This could lead to NTS users and consumers being exposed to significant capacity buyback costs if incremental capacity is delivered after its due date.

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<sup>15</sup> UNC modification proposals, modification reports and representations can be viewed on the Joint Office of Gas Transporters website: [www.gasgovernance.co.uk](http://www.gasgovernance.co.uk).

<sup>16</sup> As set out in Standard Special Condition A11(1) of the Gas Transporters Licence: <https://epr.ofgem.gov.uk/Content/Documents/Standard%20Special%20Condition%20-%20PART%20A%20Consolidated%20-%20Current%20Version.pdf>

The current arrangements could discourage NTS users from investing in the NTS, particularly in relation to complicated incremental capacity projects which require a more extensive planning process.

UNC452V and UNC465V will help avoid these problems by codifying parts of the PARCA proposals. In particular, both modifications will implement a process, including time limits, which align the release of incremental capacity to the requirements of the planning process. This will provide the NTS users and NGGT with greater flexibility to signal for and deliver capacity, taking into account planning system obligations and requirements.

The modifications maintain a transparent capacity allocation mechanism by incorporating a PARCA window and an ad hoc QSEC auction into the PARCA process. The PARCA window will allow other NTS users to signal for incremental capacity at NTS points where a PARCA has been requested. NGGT will be able to consider requests together and so efficiently manage the release of NTS capacity at NTS points where multiple requests have been received. Encouraging NTS users to signal their capacity requirements at the same time may also reduce the risk of NGGT developing projects and investing in capacity that is not required. For example, if an applicant terminates a PARCA at a point where, during the PARCA window, other NTS users had come forward, those other NTS users will be able to use that capacity for the benefit of consumers without a new application process. This would mean that NGGT's investment would produce consumer benefits in line with the original timetable.

The ad hoc QSEC auction will allow NTS users to secure unsold "obligated capacity" before it is used to meet an incremental capacity request. We think this will make sure capacity continues to be allocated transparently to NTS users who are prepared to take on a full user commitment. It also minimises the risk that unsold "obligated capacity" is reserved from the market and other NTS users who could use it to flow gas onto the NTS, increasing security of supply and benefiting consumers.

UNC452V and UNC465V allow non-code parties who are NTS users to secure incremental entry capacity for the first time. This brings the incremental entry capacity provisions in line with exit capacity provisions. We consider this is an improvement on the current arrangements.

Both modifications require PARCA applicants to provide planning and capacity information to NGGT by defined demonstration dates as they progress through the PARCA process. If they fail to do so three times in a row, NGGT can terminate the PARCA application. This proposal also brings incremental entry capacity release into line with existing exit capacity provisions.

We think this is an improvement on current arrangements. It will help ensure NGGT operates and maintains an efficient network by mitigating the risk of it proceeding with incremental capacity projects that NTS users are not fully committed to. It should enable unsold "obligated entry capacity" to be returned to the market as soon as possible if the NTS user does not intend to proceed with the PARCA.

*Standard Special Condition A11 1(d): Securing of effective competition: (i) between relevant shippers; (ii) between relevant suppliers; and/or (iii) between DN operators (who have entered into transportation arrangements with other relevant gas transporters) and relevant shippers*

We consider UNC452V and UNC465V will continue to secure effective competition between shippers on the NTS.

The current capacity arrangements are based on shippers making an upfront commitment to pay for incremental capacity and NGGT being able to provide that capacity in default lead times. If NGGT cannot provide capacity in those lead times it could mean shippers are less likely to commit to pay for incremental capacity at the auction or application window processes, before a long and uncertain planning process has been successfully completed. This may be a particular issue at constrained and high demand parts of the NTS which would require significant reinforcement work.

We consider this could affect effective competition for capacity by deterring shippers from investing in the NTS, and mean the investment signals NGGT receive are inefficient.

Both modifications will change the capacity release process to reflect planning process requirements. In this respect, UNC452V and UNC465V will avoid a barrier to effective competition between gas shippers being created. Both modifications implement the same staged process to align capacity release to the requirements of the planning system. The potential risk to NTS users under current arrangements is mitigated as they will not be required to commit to the capacity before planning permission has been granted. This should remove one deterrent to NTS users taking complicated incremental capacity projects through a potentially long planning process.

We are satisfied that requiring NTS users to securitise planning and consenting activities will continue to secure effective competition and protect consumers. This will guard against spurious incremental capacity applications – which could reserve capacity unnecessarily from the market - and cover the costs associated with planning applications that are terminated by the PARCA applicant.

Implementing UNC452V or UNC465V will not significantly increase effective competition or the supply of gas to the GB market. However, implementing either modification will lower the risk that competition and, correspondingly, gas supplies will decline due to problems delivering incremental capacity in existing capacity arrangements.

*Relevant objective (c) Compliance with the connection charging methodology results in charges which reflect, as far as reasonably practicable (taking account of implementation costs), the costs incurred by the licensee in its transportation business and, where the Act enables, to charge a reasonable profit*

Both modifications contain the same provisions to calculate the PARCA Application Fee. NTS users will be required to pay the fee when they make an incremental capacity request. It covers the costs of NGGT's initial analysis of how the capacity can be delivered.

The PARCA application fee seeks to cover NGGT's actual costs, and should therefore provide an appropriate level of protection for PARCA applicants, other users and consumers. NTS users will be required to pay an upfront amount before NGGT undertake any work. This will be reconciled at the end of phase one of the PARCA process against the actual costs incurred by NGGT to complete the analysis.

If actual costs incurred are greater than the PARCA Application Fee, the NTS user will be billed for the outstanding amount. If actual costs are lower than the PARCA Application Fee, the NTS user will be refunded the excess amount.

We believe the upfront payment of the PARCA Application Fee will guard against spurious applications for incremental NTS capacity. This will protect consumers and NTS users from potentially bearing unnecessary costs related to applications which NTS users are not fully committed to.

UNC452V and UNC465V amend the Connection Charging Methodology to outline how the PARCA Security Amount will be calculated. Both modifications propose different formulas to calculate the PARCA Security Amount -

- UNC452V proposes to use the indicative entry or exit capacity price at the NTS point capacity has been requested, multiplied by the amount of capacity requested.
- UNC465V proposes to use an average of all NTS entry or exit capacity charges, multiplied by the amount of capacity requested.

Both modifications propose that the collection of the PARCA Security Amount is phased over a four year period in 25% increments.

The PARCA Security Amount will cover NGGT's costs for PARCA applications that are terminated before a planning submission is made or because planning permission has been refused. This will help protect consumers from incurring network costs related to terminated PARCAs.

We expect PARCA termination to be a rare event. The vast majority of PARCAs should proceed through the planning process. In the event termination does occur, NGGT will collect the PARCA Security Amount and deduct it from the actual costs it incurred during the planning process. The outstanding balance will then be passed through to NGGT's allowed revenues. Under the NGGT licence changes we have proposed to implement PARCAs, if for any reason NGGT is not entitled to collect the termination amount, it must absorb in full the costs of the planning stage with no pass-through to consumers.

As capacity charges will be used to calculate the PARCA Security Amount, neither UNC452V or UNC465V will be completely cost reflective. There will always be a mismatch between the actual costs NGGT incurs and the PARCA Security Amount required from the PARCA applicant.

However, we consider UNC465V will facilitate this objective better because it is likely to result in a lower degree of mismatch. Planning costs incurred by NGGT will be based on the development of the planning application and necessary public consultation work. These costs should not vary significantly by location, nor by the relative cost of capacity at different locations. It is more likely that the overall size and complexity of the planning application will have an impact on the costs incurred by NGGT.

Calculating the PARCA Security Amount based on the average NTS entry or exit charges will ensure that PARCA applicants face the same PARCA Security Amount charge rate regardless of where they request capacity. In our view, this will reflect better the costs incurred by NGGT when carrying out the planning activities required to secure planning consent across different points on the NTS. The cost of this work, such as the development of routing options, surveys and drafting public consultations, is not directly related to the capacity charge at a particular location. They are largely costs which will not vary depending on the location NTS capacity has been requested.

We considered whether the PARCA Security Amount provisions outlined in UNC452V should be implemented. We accept that there is some merit to this proposal as it would maintain a link between the incremental capacity reserved for an NTS user and the prevailing level of capacity charge at that NTS point. This could be more cost-reflective as the PARCA Security Amount will be based on capacity charge which reflects the costs of making NTS capacity available.

However, capacity charges vary significantly across the NTS. Basing the PARCA Security Amount on specific capacity charges could mean NTS users are required to put up significantly different security amounts for projects of a similar size and requiring a similar amount of consultation work. If a PARCA is terminated at an NTS point with a low capacity charge, and hence a low PARCA Security Amount, NGGT could under-recover its planning costs and collect any outstanding balance from NTS users and consumers. Alternatively, if a PARCA is terminated at an NTS point with a high PARCA Security Amount, NGGT could over recover against its planning costs and pass the remaining amount back to NTS users.

We believe both these outcomes are inefficient and would result in a loss of economic benefit to consumers or the PARCA applicant.

We think UNC 465V will help reduce the likely difference between the PARCA Security Amount collected and NGGT's incurred costs because PARCA applicants will pay the same charge rate regardless of where they request capacity. This will minimise the potential for very high or low PARCA Security Amounts to be required from PARCA applicants and the pass through of termination cost shortfalls or excesses to other NTS users and consumers.

We accept that neither modification will match perfectly the PARCA Security Amount collected from PARCA applicants with NGGT's incurred costs. For the reasons outlined above, we consider UNC 465V has a lower risk of significant differences leading to inefficient costs for consumers or PARCA applicants.

NTS users could consider this aspect of the proposals in future and submit revised security provisions for our consideration if they wish.

*d) ...the connection charging methodology, as far as reasonably practical, properly takes account of developments in the licensee's transportation business*

Under current arrangements, NTS users are required to signal a financial commitment for incremental capacity before it is delivered. NGGT is also required to meet licence-defined lead times to deliver incremental capacity to NTS users.

As described above, there are concerns the requirements of the planning process could mean current arrangements may inhibit incremental capacity delivery. In particular, NTS users might be less able to commit to pay for incremental capacity if a long and uncertain planning process is required for the capacity to be delivered to them. There are concerns that the planning process may mean NGGT cannot deliver capacity in current lead times.

Implementing the PARCA arrangements is intended to resolve these issues. PARCAs will set up a capacity release process which matches the delivery of incremental capacity to the planning process requirements. NTS users will not be required financially to commit to capacity until it is certain that capacity can be delivered to them.



Both modifications propose to codify the same PARCA processes in the UNC. We consider both modifications take into account developments in NGGT's transportation business and propose an adequate solution.

*e) compliance with the connection charging methodology ensures that the licensee shall not show undue preference towards, or undue discrimination against any person who operates, or proposes to operate, a pipe-line system in relation to the connection of that system to the pipe-line system to which this licence relates*

We have explained above that we consider both modifications would introduce transparent and non-discriminatory arrangements for all NTS users.

### **Decision notice**

In accordance with Standard Special Condition A11 of the Gas Transporter's Licence, the Authority hereby directs that modification proposal UNC465V: 'Introduction of the Planning and Advanced Reservation of Capacity Agreement (PARCA), Weighted Average PARCA Security' be made.

**Andy Burgess**  
**Associate Partner, Transmission and Distribution Policy**

**Signed on behalf of the Authority and authorised for that purpose.**