

To all stakeholders and interested parties

Direct Dial: 020 7901 3105
Email: max.lambert@ofgem.gov.uk
Date: 14 May 2021

Informal consultation on removing user commitment for Gas Distribution Networks (“GDNs”) booking exit capacity up to and including baseline

User commitment is charged to users (shippers and GDNs) for their bookings of entry capacity and exit capacity. It is intended to ensure users are financially committed to their National Transmission System (“NTS”) capacity bookings in advance of the capacity being used. It provides a signal of future demand to National Grid Gas (“NGG”), which supports its decision making in respect of network planning. Information from user commitment is also used by NGG in its substitution analysis, to satisfy its obligations under special condition 9.17.9(b).¹

During the development of NGG’s Gas Transporter licence for RIIO-2 (the “licence”) and the associated Exit Capacity Planning (“ECP”) guidance document,² concerns were raised by GDNs about user commitment for booking NTS Exit (Flat) Capacity³ up to and including baseline obligated levels.⁴ The ECP guidance was introduced to ensure there is no loss of efficiency in the booking of NTS Exit Capacity as a result of removing the RIIO-1 GDN Exit Capacity booking incentive.⁵ GDNs have said user commitment does not support the application of the ECP Guidance, as it means that GDNs will have to continue paying charges for the original capacity that they booked even when they want to reduce their bookings to align with any downward revision in their 1-in-20 demand forecasts.⁶

¹ Special condition 9.17 (Entry and Exit Capacity obligations and methodology statements) in National Grid Gas plc Gas Transporter Licence (the “licence”) stipulates that NGG must ensure that “Exit Capacity Substitution is effected in a manner which seeks to minimise the need to make an application under Special Condition 3.13 (Funded incremental obligated capacity Re-opener and Price Control Deliverable), taking into account the Exit Capacity that Shippers and DN Operators have indicated that they will require in the future *through making a financial commitment to the licensee*”. [emphasis added]. The link to the licence is here:

<https://epr.ofgem.gov.uk/Content/Documents/National%20Grid%20Gas%20Plc%20-%20Special%20Conditions%20Consolidated%20-%20Current%20Version.pdf>

² The Exit Capacity Planning (“ECP”) guidance document was published on 19 March 2021 at the link here: <https://www.ofgem.gov.uk/publications-and-updates/exit-capacity-planning-guidance>

³ As outlined in the Exit Capacity Release methodology statement (“ExCR”) and the Uniform Network Code (UNC), Transportation Principal Document Section B, NTS Exit (Flat) Capacity is “capacity which a user is treated as utilising in offtaking gas from the NTS at a rate which (for a given Daily Quantity) is even over the course of a Day”. The link to the current ExCR is here: <https://www.nationalgrid.com/uk/gas-transmission/document/128006/download>

⁴ Special condition 9.13 (Capacity requests, Baseline Capacity and Capacity Substitution) lists each NTS Exit Point and its level of baseline obligated capacity (in GWh/d).

⁵ An incentive mechanism existed during RIIO-1 that incentivised GDNs to minimise the cost of booking sufficient NTS exit capacity to meet their 1-in-20 peak demand obligations, which exposed them to some of the costs of their bookings.

⁶ Standard Licence Condition 16 (Pipe-Line System Security Standards) of the Gas Transporter Licence, outlines the “1-in-20” licence obligation on gas transporters, including GDNs. This licence obligation can be accessed at the link here: https://epr.ofgem.gov.uk/Content/Documents/Gas_transporter_SLCs_consolidated%20-%20Current%20Version.pdf

This letter is our⁷ informal consultation on the removal of user commitment for GDNs booking NTS Exit (Flat) Capacity up to and including baseline. The reasons for conducting this informal consultation are set out below.

Applying user commitment for exit capacity booked within baseline

NGG's Exit Capacity Release methodology statement ("ExCR")⁸ outlines that user commitment applies to "all increases in users' allocations of Enduring Annual NTS Exit (Flat) Capacity" within baseline obligated levels.⁹ The ExCR sets out how, when a user requests an increase in this exit capacity, they agree to hold the capacity for four years. The amount of user commitment (£) is calculated as charges over the four year time period, using the indicative capacity price and the increased amount of capacity. Users have to pay the full user commitment amount to secure the increased capacity they've booked. They cannot reduce this capacity booking until the full user commitment amount has been paid.

GDNs and user commitment for exit capacity bookings

GDNs are in a unique position as users of the NTS as they have an obligation to book capacity to meet 1-in-20 peak demand for conveying gas to consumers. Where long-term demand goes up, capacity bookings must increase to meet that demand. When a user (including a GDN) books NTS Enduring (Flat) Exit capacity within baseline, they will incur four years of capacity charges because of the user commitment rules.¹⁰ If a GDN's 1-in-20 demand forecast subsequently decreases, the GDN is unable to reduce their capacity holdings as they are locked into these user commitment charges. This can force GDNs to maintain their capacity holdings even if they are no longer needed (due to lower demand forecasts), leading to "sterilised" capacity that cannot be accessed by other users, and increased costs for those connected to GDNs, including the end consumer.

Following the removal of GDNs' Exit Capacity booking incentive for RIIO-GD2, exit capacity bookings are now treated entirely as pass through costs and are therefore paid for by end consumers. The GDNs book exit capacity wholly on behalf of these consumers, at 1-in-20 peak demand levels, but do not have the flexibility to revise bookings downwards where demand forecasts are reduced as user commitment locks them into capacity charges, with the higher costs then passed onto end consumers.

Restricting flexibility of exit capacity bookings for GDNs may not ensure that all aspects of the booking process are managed in a way that is to the benefit of the gas transportation network as a whole, which is a principle of the ECP Guidance. System wide flexibility also forms a central part of the plans for full-chain flexibility in Ofgem's Forward Work Programme,¹¹ and actions should be taken to optimise the system and minimise network costs. The transition to net zero is also likely to result in changes in the use of methane gas by consumers, meaning that revisions in GDNs' 1-in-20 demand forecasts may become more frequent.

GDNs have shown support for the removal of user commitment for all bookings up to and including baseline capacity levels. In 2017, Wales and West Utilities (WWU) responded to NGG's review of its ExCR to argue user commitment should not apply to capacity purchased

⁷ References to the "Authority", "Ofgem", "we" and "our" are used interchangeably in this document. The Authority refers to GEMA, the Gas and Electricity Markets Authority. The Office of Gas and Electricity Markets (Ofgem) supports GEMA in its day to day work.

⁸ In accordance with special condition 9.18.5, NGG must have in place an Exit Capacity release methodology that sets out how it meets its licence obligations in the sale of Obligated Exit Capacity. NGG outlines user commitment arrangements for exit capacity in the ExCR.

⁹ The ExCR also sets out how it releases Incremental Exit Capacity (capacity above baseline) in accordance with the obligations in special condition 9.18, and outlines the user commitment arrangements for Incremental Exit Capacity.

¹⁰ This level of capacity charges is current at the time of writing. As described further down in this letter, NGG's consultation on changing this level of user commitment from four to two years closed on 16 April 2021.

¹¹ The link to Ofgem's Forward Work Programme 2021/22 is here: <https://www.ofgem.gov.uk/publications-and-updates/forward-work-programme-202122>

within baseline,¹² and raised a Uniform Network Code (UNC) modification (subsequently withdrawn) to address this.¹³ As part of the ECP guidance consultation, GDNs again raised concerns that user commitment would restrict future reductions of capacity where 1-in-20 peak demand calculations change. In respect of the transition from a financial incentive in RII0-GD1 to the ECP Guidance in RII0-GD2, GDNs said that the current user commitment framework does not support “a responsive means of agreeing capacity requirements between the NTS and GDNs”.¹⁴

Informal consultation on user commitment for GDNs booking exit capacity up to and including baseline

We are asking for views on whether user commitment on NTS Enduring (Flat) Exit capacity bookings within and up to baseline obligated levels should be removed for GDNs, given the unique requirement for GDNs to book capacity to meet their 1-in-20 peak demand obligations. We are not consulting on the removal of user commitment for other users. We welcome views from all users and other interested parties.

As part of its review and consultation on its capacity release methodology statements, NGG has proposed to lower the user commitment level for all users booking capacity within baseline from four years to two years in the ExCR. NGG has recognised that the current situation does not allow for users to amend bookings when demand forecasts change which “may lead to sterilising capacity, increased costs to GDNs and National Grid NTS making inefficient and uneconomic decisions based on inaccurate capacity bookings”.¹⁵ In their joint response to NGG’s consultation, GDNs reiterated their concerns about user commitment, and argued it should be reduced to zero for GDNs booking capacity within baseline.¹⁶

In accordance with special condition 9.18.12 of the licence, we are required to make a decision on NGG’s proposed revisions to the ExCR. That decision, including whether to approve NGG’s proposed change to user commitment within baseline, is separate to this informal consultation. Any decision we make in relation to NGG’s proposed revisions to the ExCR should not necessarily be taken as precedent for any next steps we decide following this informal consultation.

In this informal consultation, we are seeking views as to whether user commitment for GDNs booking NTS Exit (Flat) capacity up to and including baseline should be completely removed. We will publish a summary of the consultation responses and next steps, if any, following the close of the consultation.

Responses to this consultation must be sent to Gas.TransmissionResponse@ofgem.gov.uk **by 5pm on 11 June 2021.**

Unless marked confidential, all responses will be put on our website, www.ofgem.gov.uk. You can ask for your response to be kept confidential and we will respect this, subject to any obligations to disclose information, for example, under the Freedom of Information Act 2000 or the Environmental Information Regulations 2004. If you would like your responses

¹² Letter from Wales & West Utilities (WWU) “Consultation on Gas Capacity Methodology Statements”, 16 May 2017. The letter can be found here: <https://www.nationalgrid.com/sites/default/files/documents/8589940353-Consultation%20response%20%E2%80%93%20WWU%20%28May%202017%29.pdf>

¹³ UNC671 – New Capacity Exchange Process at NTS Exit Points for capacity below baseline. See the UNC671 Workgroup Report here: https://www.gasgovernance.co.uk/sites/default/files/ggf/book/2019-04/Workgroup_Report_0671_v_1.0.pdf

¹⁴ GDNs provided these views as part of a joint response to Ofgem’s draft of the ECP Guidance document, dated 29 January 2020.

¹⁵ Special condition 9.18.10 (a) of the licence requires NGG to review exit capacity release arrangements (as part of the Exit Capacity Release methodology statements) in consultation with Relevant Shippers, DN Operators and any other interested parties. The consultation ran from 19 March 2021, and closed on 16 April 2021, following which NGG submit to the Authority its consultation report with any representations made. The formal consultation cover letter can be found at the link here: <https://www.nationalgrid.com/uk/gas-transmission/capacity/capacity-methodology-statements>

¹⁶ The joint Gas Distribution Network (GDNM) response to NGG’s consultation, dated 12 April 2021, can be accessed at the link here: <https://www.nationalgrid.com/uk/gas-transmission/document/135331/download>

to be kept confidential, clearly mark your document(s) to that effect and include the reasons for confidentiality.

If you have any questions on this consultation, please contact Max Lambert at max.lambert@ofgem.gov.uk or on 0207 901 3105.

Yours sincerely,

David O'Neill

Head of Gas Markets and Systems