

*Please note: an amendment to this letter was made on 24<sup>th</sup> April. A paragraph pertaining to the period between the preliminary and formal consultations has been deleted. The deleted paragraph should be ignored, but remains visible in this letter via change marking for the purposes of transparency.*

To all interested parties,

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## **National Grid Gas's Formal Consultation on Capacity Methodologies and Statements**

National Grid Gas plc's ("National Grid") Gas Transporter Licence in respect of the NTS ("the Licence") sets out obligations to develop and modify the:

- Entry Capacity Release Methodology Statement ("ECR"); and
- Exit Capacity Release Methodology Statement ("ExCR");

together, the 'capacity release methodology statements' defined in Special Condition 9B, and the

- Entry Capacity Substitution Methodology Statement ("ECS");
- Exit Capacity Substitution and Revision Methodology Statement ("ExCS"); and
- Entry Capacity Transfer and Trade Methodology Statements ("ECTT");

together, the 'Capacity Methodology Statements' defined in Special Condition 9A.

As part of the review process for these statements, we are formally consulting with interested parties on the proposed changes. This follows the preliminary consultation on the statements held earlier this year (launched 12<sup>th</sup> January). Alongside this consultation we are also publishing our conclusions report addressing comments received during the preliminary consultation.

It remains the case that no material changes are proposed to the ECS, ExCS and ECTT at this time, and focus of change is on the ECR and ExCR methodology statements.

This letter identifies the proposed changes, and the reasons for them. Any updates following the preliminary consultation are also identified.

### **Drivers for change**

#### **Relevant UNC modifications that have been implemented**

We have worked closely with industry to develop new processes under the following UNC Modifications:

- 0616s: "Capacity Conversion Mechanism for Interconnection Points";
- 0628s: "Standard Design Connections: PARCA process";

These changes have been implemented in the UNC, and should also be incorporated in the ECR and ExCR.

We also note that Ofgem are considering introducing a more streamlined process for adding points to the Licence, in accordance with the Customer Low Cost Connections (CLoCC) ambition to connect customers

to the NTS faster, and so some minor wording changes have been made to the ECR and ExCR to prepare for this.<sup>1</sup>

#### EU Network Code on Tariffs (TAR code) & the GB Charging Review

It is anticipated that any new charging methodology will no longer be based on the Long Run Marginal Cost (LRMC) approach. Assuming this is the case then the economic test would become inoperable if no changes at all were made to it. A revised test has been proposed that uses concepts from the economic test prescribed within the EU Codes, as well as outcomes from recent industry discussions. Note: the revised test proposed here is not dependent on any particular outcome of the charging review, and so should be considered as 'all weather' with regards to whatever charging methodology is put in place. As the premium is currently capped at P20 under the current NPV methodology then implicitly this necessitates a considerable capacity commitment from applicants to be able to generate enough incremental revenue to pass the test. Upon removing this cap, then we have felt it is necessary to introduce an explicit capacity commitment rule, however we have sought to keep this requirement no more than what is strictly necessary to underpin a sustained incremental signal and to facilitate the development of the network in an economic and efficient manner.

Following the preliminary consultation then we have made 3 changes to the NPV test which are described in more detail in the 'changes' section.

- 1) Project Cost determination.
- 2) Proposed transition rule regarding the project cost for 'in-flight' PARCAs.
- 3) Any changes to the 16 quarter PARCA application rule in the UNC would flow through to the ECR.

It is also anticipated that there will be the removal of zero reserve price for within day auctions as a result of implementation of the TAR code. In the preliminary consultation then removal of the clearing allocation was considered, however it is now proposed to amend the clearing allocation obligation in the ECR rather than remove it.

#### Ofgem RIIO Consultation

In the December sector specific consultation on Gas Transmission, while discussing access arrangements to the NTS, Ofgem queries: 'The need for an economic test for capacity demands that can be met wholly from substitution.' It should be noted that the revised NPV test proposed by us as part of this review achieves this outcome.

#### Planning and Advanced Reservation of Capacity Agreement (PARCA)

Stakeholders have queried whether ad-hoc applications received during a PARCA window should be processed, rather than sitting in a queue waiting for the PARCA to resolve. This would allow parties to respond to PARCAs on Exit, in a similar way to how the ad-hoc QSEC auction allows parties to respond to PARCAs on Entry. We are proposing to make this amendment in the ExCR.

#### Daily Capacity Release

We believe it is not economic or efficient to continue to sell daily capacity into a constraint, and therefore will consider withholding daily capacity from auctions in constraint scenarios. This rule is already contained within the ECR however it is not within the ExCR. For consistency and transparency then we propose to add this approach into the ExCR. This is also consistent with changes proposed under our recent consultation on System Management Principles<sup>2</sup>.

#### Other Updates

It wasn't clear in either the ECR or ExCR that competing auctions can apply at interconnection points where there is more than one adjacent Transmission System Operator. Some clarification text has been added in to confirm this is the case.

It's not clear that a chapter on IP pricing is strictly necessary within the ECR and ExCR, given the information is also contained within the Charging Methodology. These chapters have therefore been deleted, but with the key pieces of information incorporated into other sections.

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<sup>1</sup> See 'New Points Informal Consultation 2018' for further info: <https://www.nationalgridgas.com/connections/applying-connection>

<sup>2</sup> <https://www.nationalgridgas.com/about-us/how-were-regulated/gas-industry-compliance>

A number of legacy references to ARCA exists within the ExCR. As there are no longer any live ARCAs then we are proposing to remove these sections.

#### Relevant UNC modification proposals that are in development

Regarding any live modifications following the charging review then please refer to the earlier section on 'TAR code and GB Charging Review'.

Regarding UNC modification proposal 667<sup>3</sup>, then we have been engaging with industry and listening to concerns raised regarding the economic test. This feedback has helped shape the proposals we have put forward, as part of this review.

Regarding UNC modification proposal 671<sup>4</sup>, we note there may be some impact on user commitment here, and an alternative route for acquiring capacity at a particular point. Once this modification has completed development then we will establish what changes, if any, are required to the statements, and propose further revisions accordingly.

#### **Changes**

The main changes that have been made to the statements are detailed below:

- **Entry Capacity Release Methodology Statement:**
  - The reference to the obligation for a clearing allocation has been amended.
  - We proposed under our preliminary consultation to calculate a project cost using the generic revenue driver methodology (GRDM). This is consistent with the approach prescribed for Interconnection Points under the EU code on Capacity Allocation Mechanisms. We later identified some concerns around this approach. A range of projects are considered for the planning process and therefore a range of revenue drivers would also need to be considered. We cannot pick out a specific revenue driver, as we cannot do anything to prejudge or undermine the outcome of the planning process. We can therefore implement a 'blind' approach using a median value of all the estimate revenue drivers for the projects. We also note that Ofgem are considering to remove the requirement for us to maintain a generic revenue driver methodology under their recent RIIO T2 consultation. This raises some questions over the sustainability of a solution using this method.  
Alternatively we have considered using a more generic approach that does not use the specific solutions being put forward under the planning process. This idea was suggested to us in the March Transmission Workgroup. We believe this would resolve the problems identified above for the revenue driver approach. We already have a generic method in the form of the Project Values produced under the Long Run Marginal Cost (LRMC) methodology. We are therefore proposing to use a simplified version of this to continue to produce project values. The simplification purely relates to removing element of the Tariff model that are only required when producing prices, they are not required for producing project values. The approach would therefore be to calculate the marginal cost (as is done now) and convert this directly into the project value using the expansion coefficient. We acknowledge there may be further refinements possible but in the first instance we want to adhere to proposing a method that is established and proven, and so we have only removed the parts of LRMC that it clearly makes sense to do so.  
Our 'minded to' position is to use the more generic approach derived from LRMC, however we are happy to hear views on both options. The generic project value approach is contained within the main ECR Statement, and alternative drafting for the GRDM approach can be seen in appendix I of this letter.
  - We asked participants about the appropriateness of a transition rule for project cost in the preliminary consultation, and indicated that we were minded to introduce such a transition rule at industry discussions in the transmission workgroup. As this proposal changes the basis on which the project cost is determined then we continue to believe it is appropriate to implement a transition rule. We are therefore proposing that the project cost is locked in (subject to inflation) at the prevailing value at the time of implementation of the updated ECR, rather than have it be recalculated in line with the new method.
  - We note the challenge made on the inclusion of the 16 quarter PARCA application rule within the NPV test following the preliminary consultation. We are still not willing to create

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<sup>3</sup> A proposal for 'Inclusion and Amendment of Entry Incremental Capacity Release NPV test in UNC'.

<sup>4</sup> A proposal for a 'New Capacity Exchange process at NTS exit points for capacity below baseline'.

a framework that potentially creates lower user commitment for applications for funded incremental compared to applications for existing capacity or substitution. In practical terms this could make it more attractive to connect to constrained / congested parts of the network, compared to unconstrained / uncongested parts of the network.<sup>5</sup> However we understand the concerns raised, and consequently we have drafted the ECR in such a way that should the 16 quarter rule in the UNC be reduced for non-incremental capacity, then it would also be reduced for incremental capacity and substitution.

- The section on PARCA has been amended to include the new additions from UNC modification 628s, notably the concept of a 'capacity indicator'.
  - Chapter 6 has been amended to recognise: a new way to determine the project cost used in the Economic Test; a new way to determine the capacity price premium for PARCA projects requiring incremental capacity; a rule to determine the amount of incremental capacity signalled; and various corresponding clarifications to how the new proposed Economic Test would work.
  - The inclusion of the amount of capacity released through Capacity Conversion (Interconnection Points only).
  - Removal of IP pricing as a stand alone chapter.
  - Confirm competing auctions may apply at IPs.
- Exit Capacity Release Methodology Statement:
    - Process ad-hoc applications received during the PARCA window.
    - The section on PARCA has been amended to include the new additions from UNC modification 628s, notably the concept of a 'capacity indicator'.
    - Legacy references to ARCA are removed.
    - Text has been added explaining that we may withhold daily capacity from sale in the event of a constraint.
    - The inclusion of the amount of capacity released through Capacity Conversion (Interconnection Points only).
    - Removal of IP pricing as a stand alone chapter.
    - Confirm competing auctions may apply at IPs.
  - All Statements:
    - Housekeeping updates to weblinks and dates.
    - Technical clarifications.

To assist in reviewing the proposed changes to the capacity statements the following documents are available on our website <https://www.nationalgridgas.com/capacity/capacity-methodology-statements>. In each case please scroll down to the sections headed "Current Review and Consultation".

Entry Capacity Release (ECR): a clean version 4.2 and a track change from version 4.0

Exit Capacity Release (ExCR): a clean version 12.22 and a track change from version 12.0

Entry Capacity Substitution (ECS): a clean version 9.2 and a track change from version 9.0

Exit Capacity Substitution & Revision (ExCS): a clean version 7.2 and a track change from version 7.0

Entry Capacity Trade and Transfer (ECTT): a clean version 9.2 and a track change from version 9.0

The current approved version of each statement can also be found on the relevant web page.

~~Please be aware that these statements are not necessarily our final proposals. They will be developed further in the light of responses received and additional developments in industry workshops prior to the formal consultation process (as required by the Licence), which is anticipated to take place in March/April 2019.~~

We would appreciate the comments of all interested parties on the draft changes to the capacity release statements and the capacity statements. Responses should arrive with us by 17:00 on Tuesday 14<sup>th</sup> May 2019 and be sent by e-mail to [malcolm.montgomery@nationalgrid.com](mailto:malcolm.montgomery@nationalgrid.com) and copied to [box.transmissioncapacityandcharging@nationalgrid.com](mailto:box.transmissioncapacityandcharging@nationalgrid.com)

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<sup>5</sup> This reasoning was initially provided at the [Feb](#) transmission workgroup and in more detail at the [March](#) transmission workgroup.

Alternatively they can be sent by post to the above address marked for the attention of:  
"Malcolm Montgomery", Floor D2

Responses will be placed on our website and incorporated within the consultation conclusions report. If you wish your response to be treated as confidential then please mark it clearly to that effect.

Yours sincerely,

Chris Logue  
Market Change Delivery Manager

## **Appendix I – alternative drafting for a project cost based on the generic revenue driver methodology**

### *Paragraph to be inserted into Chapter 6 of the ECR*

The initial project cost will be the estimated increase in National Grid’s allowed revenue determined in accordance with the Generic Revenue Driver Methodology Statement (GRDM). Note this can include any increase in target for the constraint management incentive.

Where the estimate is a range then the central point of the range shall be used.

Where more than one project solution has been identified, and hence there are multiple revenue drivers estimated, then:

- a) Where there is an odd number of project solutions being considered, the median revenue driver estimate will be used.<sup>6</sup>
- b) Where there is an even number of project solutions being considered, the median – 1 revenue driver estimate will be used.<sup>7</sup>

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<sup>6</sup> Where the projects have been ordered by the size of the estimated revenue driver.

<sup>7</sup> Where the ‘minus 1’ moves towards the lower value estimated revenue driver.