

Jenny Phillips
Gas Charging and Capacity
Development Manager
National Grid Gas plc
National Grid House
Warwick Technology Park
Gallows Hill, Warwick
CV34 6DA

Your Ref:
Our Ref:
Direct Dial: 020 7901 7042
Email: chris.brown@ofgem.gov.uk

Date: 4 July 2017

Dear Jenny

Approval of the Capacity Methodology Statements pursuant to Special Condition 9A and Special Condition 9B of National Grid Gas plc's gas transporter licence

Thank you¹ for submitting proposed modifications to the three Capacity Methodology Statements and two Capacity Release Methodology Statements (collectively the "Methodology Statements") to us² for approval on 30 May 2017.

We have decided to approve the changes to the Methodology Statements. The background and reasons for our decision are explained below.

Background

The EU Capacity Allocation Mechanism (CAM) Network Code was amended this year to include processes to allocate incremental capacity at Interconnector Points (IPs).³ To implement these processes, you determined a number of changes are required to the Methodology Statements listed below:⁴

- The Entry Capacity Substitution Methodology Statement ("ECS")
- The Exit Capacity Substitution Methodology Statement ("ExCS")
- The Entry Capacity Transfer and Trade Methodology Statement ("ECTT").
- The Entry Capacity Release Methodology Statement ("ECR")
- The Exit Capacity Release Methodology Statement ("ExCR").

Special Condition 9A of your Licence explains the consultation requirements to review the ECS, ExCS and ECTT. Special Condition 9B contains the same information for the ECR and ExCR. Both Special Conditions also explain that the Authority can veto the modifications within two months of receiving the Methodology Statements.⁵

In summary, consistent with Special Conditions 9A.8(b) and 9B.10(b), you consulted on the proposed changes to the Methodology Statements in April 2017.⁶ A copy of the consultation can be found on your website. There were two consultation responses⁷, described below,

¹ The terms "the licensee", "NGG" and "you" are used to refer to National Grid Gas plc in this letter.

² The terms "the Authority", "Ofgem", "we", "us" and "our" are used interchangeably in this letter.

³ The amended CAM Network Code (EU 2017/459) came into force on 17 March 2017.

⁴ Changes have also been made to the Uniform Network Code by UNC 597 and UNC 598S. Licence changes are also under development.

⁵ Special Condition 9.A6 and Special Condition 9B.11

⁶ The consultation ran between the 13 April 2017 and 16 May 2017

⁷ These are available on your website: <http://www2.nationalgrid.com/uk/industry-information/gas-capacity-methodologies/>

and you submitted the final proposed modified Methodology Statements to us on the 30 May 2017.

Special Conditions 9A.7 and 9B.9 also require any proposed changes to the Methodology Statements to be accompanied by a report from an Independent Examiner that confirms the extent to which the Methodology Statements are consistent with your Gas Act duties and Licence obligations.

In our letter dated 19 January 2017 we gave our consent that a statement from an Independent Examiner would not be required in this instance.⁸

Proposed changes to the Methodology Statements

The main modifications to the Methodology Statements incorporate the processes to allocate incremental capacity at the IPs to facilitate compliance with the CAM Network Code. In particular:

ECR and ExCR

Similar changes are proposed to both Methodology Statements to explain the processes to allocate incremental capacity at IPs – this has been mainly done by including a new Chapter 11 in the ECR and Chapter 8 in the ExCR.⁹ The changes to both Methodology Statements include descriptions of the incremental demand assessment, design and Authority Approval phases. Text has also been added explaining that incremental IP capacity will be reserved and allocated through an IP Planning and Advanced Reservation of Capacity Agreement (PARCA).

New text is also proposed to explain that the Generic Revenue Driver Methodology (GRDM) will be used to calculate the increase in allowed revenue associated with releasing incremental capacity at new IPs.

Both Methodology Statements also set out that 10% of incremental technical capacity requested at an IP will be set aside and offered for sale at a later date.¹⁰

The Economic Test to release capacity is described. This compares the Net Present Value of the capacity commitment associated with the incremental IP capacity to the increase in allowed revenue calculated using the GRDM. The test is passed if this ratio is greater than the 'f-factor' which NGGT propose to set as 50%.

There is also a description of the Mandatory Minimum Premium which can be used to increase the price paid to release incremental IP capacity in order to pass the Economic Test.

Changes have also been made to the ECR confirming that incremental IP capacity can be released under the Accelerated Release Incentive. In certain circumstances this allows incremental IP capacity to be released in advance of default lead times by being placed in an Annual Yearly Auction. The IP PARCA Applicant, or any other user, can then obtain this capacity by participating in the auction.

A number of minor typographical changes have been made to both Methodology Statements to remove out of date text, update date references, and amend paragraph cross referencing.

ECS and ExCS

⁸ A copy of this letter can be found on our website: <https://www.ofgem.gov.uk/gas/transmission-networks/entry-and-exit-capacity>

⁹ We have noticed the 'clean' version 3.2 of the ECR submitted does not list Chapter 11 in the Table of Contents.

¹⁰ Footnote 64 in the ExCR and footnote 48 in the ECR.

Relatively minor changes are proposed to both Methodology Statements explaining the substitution arrangements apply to capacity requested at IPs through an IP PARCA.

Text has also been added explaining unsold capacity will be withheld from entry capacity auctions and exit capacity application windows if it has been identified as substitutable capacity for an IP PARCA.

In the ECS, some minor changes have been made to the section dealing with capacity retainers. This has been reworded to state that the retainer window will open in January each year, rather than two months before the Quarterly and Annual System Entry Capacity Auctions.

A number of minor typographical changes have been made to both Methodology Statements to remove out of date text, update date references, and amend paragraph cross referencing.

ECCT

Only one substantive change has been to the ECCT. This removes an out of date footnote referring to how the Transfer and Trade processes work when the Bacton split occurs. Otherwise, only minor typographical changes have been made.

Consultation responses

Two responses were received to the Methodology Statements consultation. One response identified a number of typographical issues in the ECR and ExCR. The respondent also suggested that more information should be provided in a number of areas including:

- Withholding 10% of incremental capacity for offer at a later date
- How the Mandatory Minimum Premium applies in practice
- If incremental IP capacity can be offered at the NTS auction processes.

You addressed the points raised by the respondent by providing feedback in the Consultation Conclusions Report or making any required changes to the Methodology Statements.¹¹

The other respondent commented on user commitment costs associated with capacity being delivered through substitution. They indicated they may raise a UNC modification to codify the ExCS Methodology Statement.

Our views

We have carefully considered the Statements submitted by you, the consultation responses, and concluded that the modifications will better facilitate the achievement of the capacity objectives.

The proposed changes help make sure GB capacity release arrangements are compliant with the incremental capacity allocation processes contained in the CAM Network Code. The changes will mean that the Methodology Statements now include the processes to allocate and substitute capacity to IPs.

The proposed changes are consistent with the incremental capacity processes set out in Chapter V of the CAM Network Code some of which have also been implemented in the UNC by UNC 597. In particular, the changes set out the actions and timescales associated with demand assessment, the design phase, and Authority Approval.

¹¹ This can be found on your website: <http://www2.nationalgrid.com/uk/industry-information/gas-capacity-methodologies/>

The changes also implement the Economic Test into GB arrangements. The Economic Test is explained in Articles 22 to 24 of the CAM Network Code. The changes to the ECR and ExCR implement the structure and principles of the Economic Test into GB arrangements.

You propose the Economic Test calculates the ratio of capacity commitments required by a user against the estimated costs of releasing the capacity calculated through the GRDM over a four-year period.¹² We consider this is consistent with the CAM Network Code requirements.

The Economic Test also contains the f-factor which is used to determine if the incremental capacity request should progress. Article 23 states the level of the f-factor should be set by the National Regulatory Authority. The changes to the ECR and ExCR propose to set the f-factor at 50%. We are content for the f-factor to be set at this level as it provides a good balance between allowing viable incremental IP capacity projects to proceed, and preventing unviable projects. We note respondents to the consultation did not raise concerns about the level of the f-factor.

We are content for the Accelerated Release Incentive to be applied to incremental entry capacity released at IPs. This incentive encourages you to deliver incremental capacity to the market in advance of default lead times. Applying it to IPs will make sure the benefits of early release are available to shippers active at those points.

We are also content that other changes made to the Methodology Statements, for example withholding 10% of incremental capacity for sale at a later date, are consistent with the CAM Network Code provisions.

Authority's view

Following consideration of the documentation you provided pursuant to Special Condition 9A and Special Condition 9B of the Licence, and having regard to our principal objective and statutory duties, we consider that the Methodology Statements submitted on 30 May 2017 are reasonably necessary to better facilitate the achievement of the capacity objectives.

If you have any questions about this decision please contact my colleague James Thomson on james.thomson@ofgem.gov.uk.

Yours sincerely

Chris Brown
Head of Gas Systems

¹² Any four years where the aggregate volume of capacity quantity requested exceeds the Unsold Technical Interconnection Point Capacity (minus that reserved pursuant to any PARCAs or IP PARCAs).