

Gas transmission

Baseline capacities and access

Options for RII02

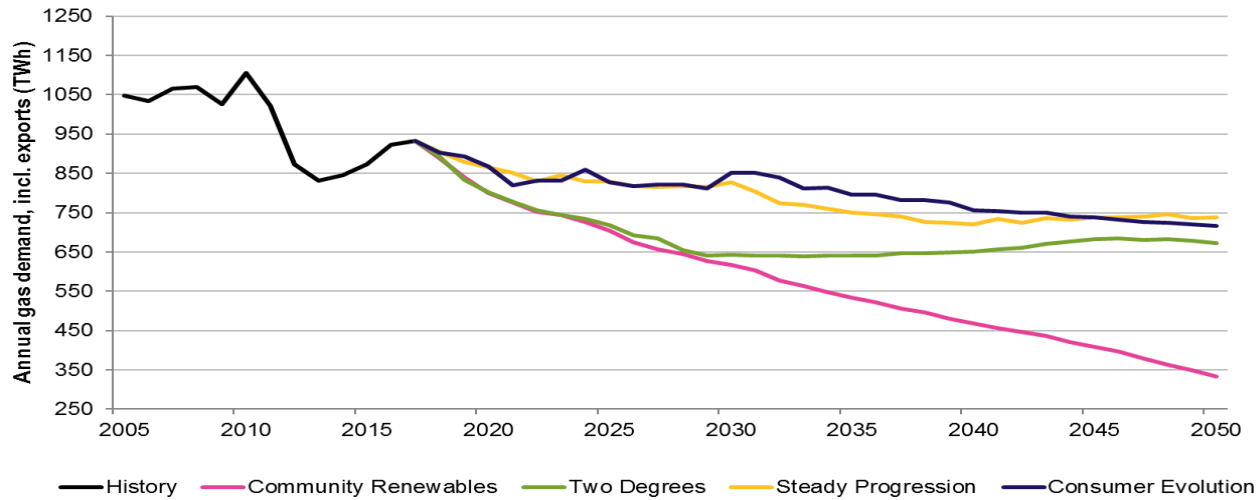


Shankar Rajagopalan (Baseline capacity)
Lea Slokar (Access arrangements)

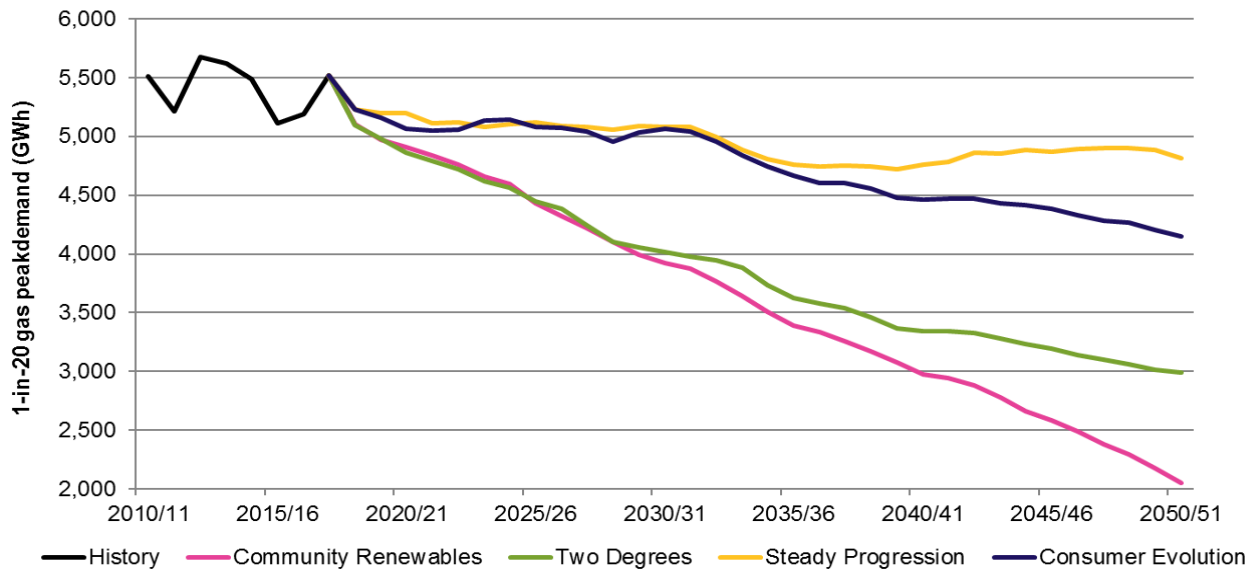
08/11/18

- The National Transmission System (NTS) has a number of:
 - entry points (where shippers can put gas into the NTS); and
 - exit points (where large demand users and GDNs can take gas out)
- NGGT's licence requires it to offer at auction specified amounts of capacity at each entry and exit point on the NTS (called obligated baseline capacities)
- The obligated levels of entry and exit capacity collectively describe the theoretical capability of the NTS. But;
 - there is no requirement to maintain actual physical capability
 - NGGT can use commercial tools in lieu of physical network capability (e.g. capacity buy-back) if it is physically unable to meet obligated levels
- The current levels of obligated entry and exit capacities were last reviewed in 2008.

- Demand and supply patterns have changed since 2008. We are not confident that the current baseline capacities are consistent with the actual physical capability of the NTS or the needs of users
- But, NGGT is under an enforceable obligation to offer the current levels of baseline capacity. This could potentially lead to consumer detriment:
 - Network investment (in new or replacement assets) could be targeted at the obligated levels of capacity and not the actual needs of users;
 - Consumers are exposed to the cost of any investment required to accommodate capacity up to the baselines
 - If the physical capability of the NTS is lower than the obligated levels, NGGT and consumers are exposed to constraint management costs
- We want to ensure that NGGT's RIIO2 business plan and the settlement is aimed at meeting future needs of NTS users – and is not purely driven by the obligation to maintain the current levels of baseline capacity

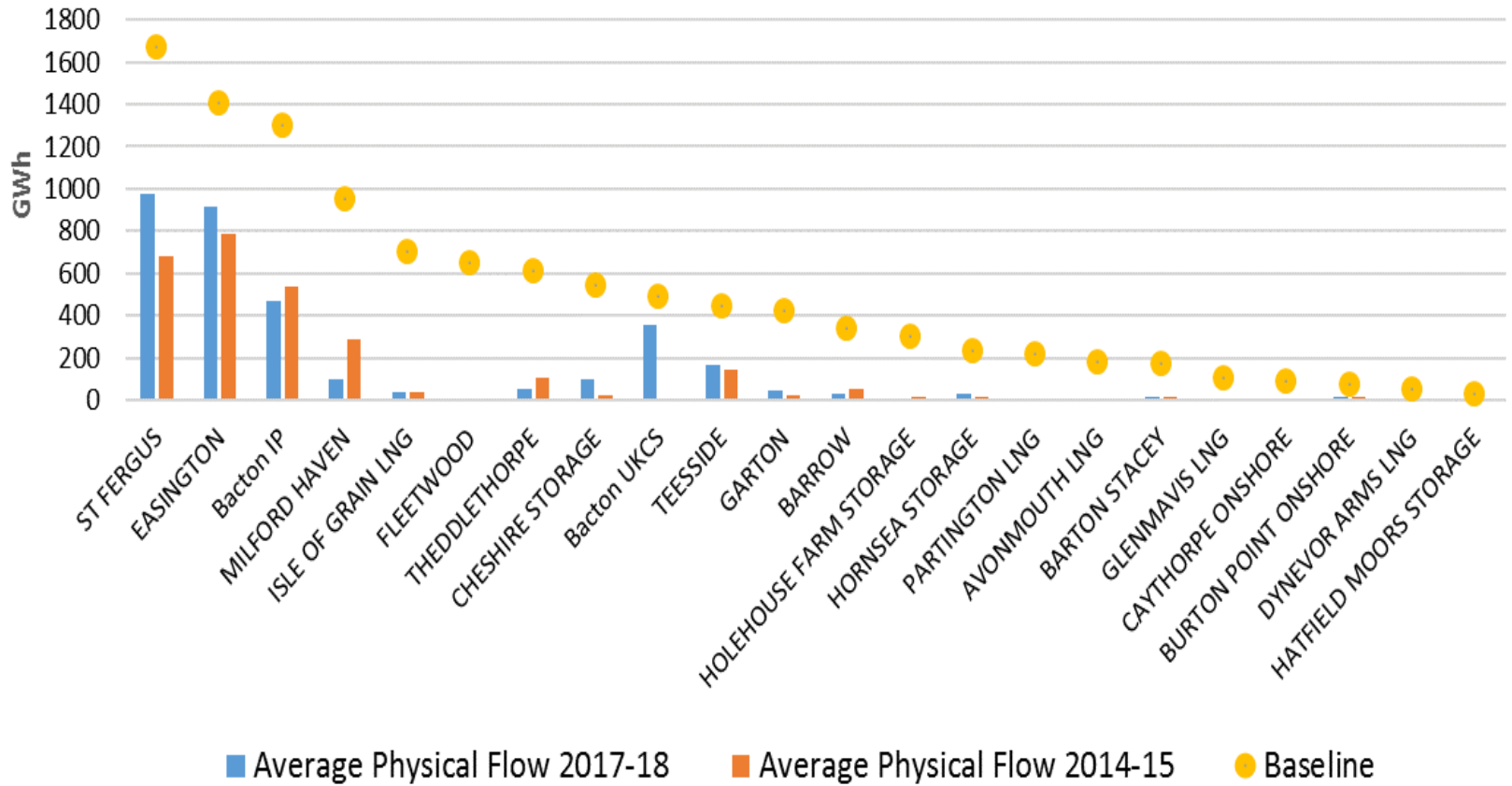


Annual gas demand (TWh)



1-in-20 diversified peak gas demand

Source: National Grid – 2018 Future Energy Scenarios



- For RIIO2, we are considering a number of options for baseline capacities,
 - Option 1: Retain the current levels of obligated baseline capacity (as we did in RIIO1)
 - Option 2: Introduce a new licence condition that would require NGGT to review the levels of obligated baseline capacities and change the levels in the licence accordingly
 - Option 3: Incorporate the requirement to review baseline capacities into our Business Plan guidance to NGGT, and reset baselines at the start of the RIIO2 price control based on NGGT's proposed levels
- NGGT is already under a licence obligation to develop and maintain the Transmission Planning Code (TPC), which sets out the methodology that it would use to determine the physical capability of the NTS. In line with the TPC, NGGT carries out "Network Capability Analysis" to identify the physical capability of the NTS under different scenarios for entry and exit capacity use.

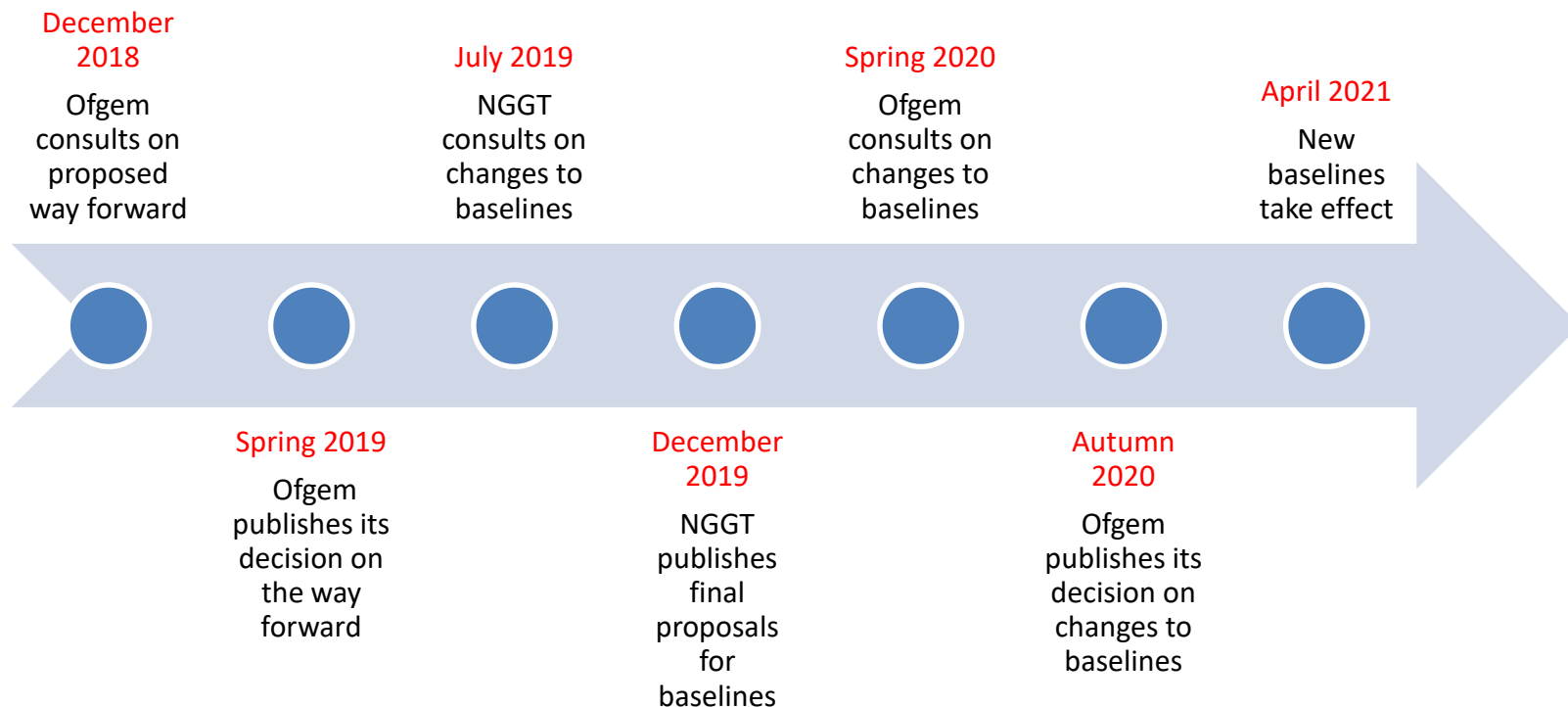
- We are developing our thinking on these options and will indicate our preferred way forward in our December RII02 methodology consultation
- Our provisional view is that Option 1 (i.e. retain current levels) carries significant risks for consumers. We think that the gas network has evolved significantly since 2008, and it is not appropriate to roll forward the current levels without considering whether they remain appropriate
- Between Options 2 and 3, we are currently of the view that Option 3 (linking the review to NGGT's business plan) is a better approach than Option 2 (i.e. a new licence condition to review baselines – but we will listen to industry views on this.
- We will be seeking stakeholder views on our preferred approach in our methodology consultation (to be published in December 2018)

- Under Options 2 or 3, we would ask NGGT to review the current levels of obligated capacities and to propose as part of its Business Plan for RII02:
 - Updated levels for baseline entry/exit capacities reflecting its forecast of the actual physical capability of the network as of April 2021 (with an appropriate uplift to reflect efficient levels of constraint risk)
 - Its target levels for baseline entry/exit capacities for March 2026, reflecting the required physical capability of the network taking account of its forecast scenarios for the evolution of supply and demand
- In carrying out its review of obligated entry/exit capacities, we would expect NGGT to take account of:
 - The current physical capability of the network
 - The current and future needs of NTS users
 - Any existing contractual commitments on entry/exit capacities
- We would expect NGGT to consult extensively with users of the NTS and other stakeholders to understand their needs as part of the review

- We would then consider NGGT’s proposals for revisions to baseline capacities as part of our assessment of NGGT’s Business Plan in 2020. We would assess whether NGGT has demonstrated that:
 - Its proposed baselines for 2021 are consistent with the physical capability of the NTS with a reasonable uplift for acceptable constraint risk
 - Its proposed target levels for baseline capacities in 2026 is consistent with reasonable forecasts of supply and demand, and reflects the needs of network users
- Subject to our assessment and consultation with stakeholders, we would then modify NGGT’s baseline obligated capacities to take effect from 1 April 2021
- Separately, we are also considering whether to set a licence condition (as an output for RII02) for NGGT to deliver the target levels of entry/exit capacity
- Our assessment of NGGT’s expenditure plans for RII02 would consider whether NGGT has demonstrated that the spend is needed to deliver the target levels of entry/exit capacity

- We are also considering whether to introduce a price control uncertainty mechanism by which NGGT or Ofgem can propose changes to the target network capability (within period).
 - This would be triggered if there are material changes to the required network capability
 - If appropriate, we could make changes to the baseline levels of capacity and price control allowances
- Where NGGT's business plan involves discrete high value investments aimed at delivering the target level of network capability, we are considering whether to categorise these projects as price control deliverables (PCDs) – with automatic return of allowances in case the investment is not needed or delivered
- We propose to ask NGGT to consider whether there are additional metrics of network capability that could be introduced into the licence – e.g. inter-zonal transfer capacity

- Baseline capacities at the start of RII02 would be more closely aligned with the actual physical capability of the NTS
- Setting a target for baseline capacities for the end of RII02 that reflects the forecast need of users would ensure that network investment is directed at meeting those needs – and not at maintaining the current obligated capacities. In the context of falling demand for the NTS, this could lead to savings for consumers
- Aligning baseline capacities with the actual physical capability of the NTS would reduce the risk of NGGT having to take constraint management actions and therefore would allow us to set lower SO incentive baselines. It would also allow Ofgem to review the baselines for the GD exit capacity incentive
- Setting targets for baseline capacities would provide Ofgem with a metric to measure NGGT's performance on network capability – and to hold NGGT to account for commitments made in its business plan



- No revision to the regime has occurred since 2008
- In the 2007 – 2012 price control period capacity trade, transfer and **substitution** were introduced; **baselines became transferable**

- Substitution **has worked well** and delivered incremental capacity where it was needed (*more than a dozen requests on exit, 2 on entry*)
- NGG receives no funding for substituting capacity.
- Since the introduction of substitution **all new incremental capacity signals** have been met in this way and without additional investment in the network delivering real benefits and lower costs for consumers.

However

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There is scope to:

- **Improve the way that unsold capacity is allocated** & provide more certainty for users;
- **Reduce the amount of regulatory intervention** current arrangements require.

The aims of the review

To facilitate increased market access to unsold entry capacity, with less regulatory intervention and greater overall efficiency.

This may
include...

- **Assessing:**
 - The continued **need for an economic test** (for capacity needs met wholly from substitution);
 - Appropriateness of **the current lead times for substitution**;
 - **Minimum quantities/durations for incremental capacity requests** wholly met by substitution;
- **Revising** the continuing **need for regulatory oversight**/approval;
- Is there a case for considering the **substitution of capacity on a zonal basis**, now or in the future, or are current nodal arrangements fit for purpose?
- What **governance arrangements** will be needed for revised capacity allocation arrangements – should this be considered as business as usual and included in the UNC?

We are considering asking NGGT to:

- Review its current arrangements for market access to unsold capacity;
 - Develop revised arrangements which achieve the aims set out; and
 - Identify an implementation plan to introduce new arrangements from April 2021 onwards.
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- Throughout the review, we expect NGGT to consult extensively with users of the NTS and stakeholders to understand and take into account their need.

Our core purpose is to ensure that all consumers can get good value and service from the energy market. In support of this we favour market solutions where practical, incentive regulation for monopolies and an approach that seeks to enable innovation and beneficial change whilst protecting consumers.

We will ensure that Ofgem will operate as an efficient organisation, driven by skilled and empowered staff, that will act quickly, predictably and effectively in the consumer interest, based on independent and transparent insight into consumers' experiences and the operation of energy systems and markets.