

**UNC Workgroup 0667 Minutes
Inclusion and Amendment of Entry Incremental Capacity Release
NPV test in UNC**

Thursday 01 November 2018

at Radcliffe House, Blenheim Court, Warwick Road, Solihull B91 2AA

Attendees

Rebecca Hailes (Chair)	(RH)	Joint Office
Karen Visgarda (Secretary)	(KV)	Joint Office
Alex Nield*	(AN)	Storengy UK
Andrew Blair*	(AB)	Interconnector UK
Andrew Pearce	(AP)	BP
Angharad Williams	(AW)	National Grid NTS
Anna Shrigley*	(ASh)	Eni Trading & Shipping
Bethan Winter	(BW)	Wales & West Utilities
Bill Reed	(BR)	RWE Supply & Trading GmbH
Colin Hamilton	(CH)	National Grid NTS
Dave Adlam	(DA)	Cadent
David Cox*	(DC)	London Energy Consulting Ltd
Edward Fyfe*	(EF)	SGN
Emma Buckton*	(EB)	Northern Gas Networks
Gerry Hoggan	(GH)	ScottishPower
Graham Jack*	(GJ)	Centrica
Jeff Chandler*	(JCh)	SSE
John Costa	(JCo)	EDF Energy
Julie Cox	(JCx)	Energy UK
Kamila Nugumanova*	(KN)	ESB
Kay Riley	(KR)	South Hook Gas
Lea Slokar*	(LS)	Ofgem
Mark Rixon*	(MR)	Engie
Paul Youngman*	(PY)	Drax
Penny Jackson*	(PJ)	Npower
Richard Fairholme	(RF)	Uniper
Shiv Singh*	(SS)	Cadent
Steve Pownall	(SP)	Xoserve
Steven Britton*	(SB)	Cornwall
Terry Burke	(TB)	Equinor

Apologies

Phil Hobbins	(PH)	National Grid NTS
Nick King	(NK)	CNG Services

*via teleconference

Copies of all papers are available at: <https://www.gasgovernance.co.uk/0667/01118>

The Workgroup Report is due to be presented at the UNC Modification Panel by 17 January 2019.

1.0 Outline of Modification

Kay Riley (KR) introduced the modification and explained the modification was seeking to insert the Net Present Value (NPV) test required for Non-IP Entry Incremental Capacity Release into the UNC, and amend the mechanics of the test to ensure that it worked effectively with the current GB system.

She explained an issue had been discovered with the Incremental Capacity Release NPV test that impacts any potential Planning and Advanced Reservation of Capacity Agreement (PARCA) applicant's ability to pass the NPV test, and subsequently reserve or allocate incremental capacity.

For Incremental Capacity to be reserved and allocated as part of the PARCA process, a series of NPV tests are required to be passed (one at the end of PARCA Phase 1 using indicative prices and an additional test at the end of PARCA Phase 2 using updated prices). The intention of the NPV tests is to ensure user commitment, and to provide sufficient assurances that the costs of any incremental investment associated with PARCA Works are recovered. The PARCA applicant is deemed to have passed the NPV tests if the test signals 50% of the Estimated Project Value.

KR said that South Hook Gas Company Ltd is the applicant under an existing PARCA Phase 1 process in respect of incremental entry capacity at the Milford Haven Aggregated System Entry Point (ASEP) as an integral part of an upstream project investment. She said South Hook Gas understood that this PARCA application is the first to be processed in respect of incremental NTS entry capacity.

She said the methodology for the NPV Test was currently defined in the Entry Capacity Release Methodology (ECRM) Statement rather than in the UNC. She said the NPV methodology was unclear and unfit for purpose in the context of a PARCA application in respect of incremental entry capacity. This was exacerbated by the current uncertainties around a potential switchover to floating prices and a different (and as yet unknown) charging methodology as a result of UNC Modification 0621 (and its alternatives).

KR said for the reasons as defined above, that the modification was seeking firstly to insert the NPV Test into the UNC and secondly, to make the changes set out in this proposed modification to the mechanics of the test to resolve significant structural issues that could currently be reducing the number of PARCA entry capacity applications and therefore disincentivising future investment in natural gas supply projects.

KR then provided an overview of the presentation UNC Modification 0667, the full document can be viewed via the link: <http://www.gasgovernance.co.uk/0667/011118>

She then talked through the timeline schematic and made reference to the short timelines, and explained given the current PARCA application from South Hook Gas and the impact of the current methodology on parties, the change is required as soon as possible. She said that South Hook Gas believe that the proposed changes would have no impact on other parties except for those signalling incremental capacity (upon whom this would have a positive impact). She then added that the solution was ensuring parties would have the ability to signal the correct amount of revenue, which provides certainty to both the signalling party and the rest of industry.

KR then overviewed the aims of the workgroup for the next three meetings, as detailed below:

- 01 November 2018 – Introduction to the minimum duration rule – to identify analysis requirements, initial feedback and identify additional topics for the following meetings.
- 06 December 2018 – NPV test in UNC (vs methodology) review of analysis – identify any further analysis required and amend the modification as required.
- 03 January 2019 – Topics TBC

KR then overviewed the PARCA Process, and the process that has to be adhered to in order to acquire incremental capacity, that parties are required to go through with regards to the PARCA process with National Grid NTS. She overviewed these various stages as laid out in the schematic.

KR then explained the issues with regards to the NPV Test which were detailed in a graph format for capacity required at Milford Haven, and she made the following comments describing this process as detailed below:

In order to complete Phase 1 and reserve the incremental capacity SHG are required to complete a Net Present Value (NPV) test. There is also a NPV test at the end of Phase 2 prior to the additional capacity being formally allocated to the applicant.

As an example

- In order to pass the NPV test SHG are required to signal incremental capacity in a minimum of 20 quarters out of 32 (this is the same for almost all entry terminals)*
- SHG are potentially required to reserve any unsold capacity that is also required during these periods (unsold is required to be reserved before incremental)*
- Given that long term capacity is not widely bought, there is a significant burden on anyone wishing to pass this test*
- The time between the first and second test also adds further uncertainty, particularly taking into account the impact of GTCR*

A lengthy general discussion then ensued regarding the stipulations of the NVP Test and entry capacity, including the amount that needs to be purchased. Graham Jack (GJ) proposed that a possible solution could be for National Grid NTS to use an exit capacity type model instead, where an upfront payment could be made by establishing the value of the User Commitment over a period of time and then that could be adopted for the entry capacity.

Dave Adlam (DA) and Julie Cox (JCx) said that this suggestion would require investment from National Grid NTS and KR said she would discuss this proposal with National Grid NTS. JCx said she recalled that the entry capacity procedure was so complicated and that this was associated with the shared risk aspect.

GJ said that it was not possible to 'hand back' entry capacity, as it was fixed and he was not sure if the NPV Test was appropriate in moving to a floating regime, but the exit approach could work in this scenario, with a premium price attached to the test. John Costa (JC) asked what was the driving force for this change? KR said it was due to more ships being incorporated and that National Grid NTS would have to make some investment, especially as South Hook Gas were paying in excess of £70m to make this happen.

Bill Reed (BR) said that a Rough Order of Magnitude (ROM) was needed and that National Grid NTS needed to look at the NPV Test. Dave Adlam (DA) said that historically the User Commitment was set for a specific value and now the situation had changed. Colin Hamilton (CH) said that there were specific rules regarding the interconnection points and the premiums for set durations. BR said to apply the test as it stands now, was disproportionate to the investment cost on the NPV Test.

KR said that certainty was required as early as possible in the overall process and said there were various pieces of work that needed to be undertaken regarding the conditions in association with the costs and the mechanics tests together with the results. BR added that this work also needed to include the User Commitment aspect as well. KR then overviewed the South Hook Gas proposed solution slide, but she said she was keen to explore the proposals that GJ had put forward too.

GJ said that a new parameter could potentially be added into the test to make an option whereby an upfront payment for the User Commitment of £70m to pass the test could be paid or this payment could be staggered, for example £30m. KR said she liked the idea of an

upfront payment and would be discussing this in more depth. GJ added that this process would still allow bids to be placed for capacity of what was required and then reduce the repayment for the extra capacity and the upfront payment. KR said that the User Commitment needed to be taken out of the Methodology Statement and put into the UNC .

KR then provided an overview of the Minimum Duration Rule as detailed below:

KR said that South Hook Gas did believe that the role of the NPV test was to ensure a PARCA applicant signals the required revenue commitment (currently 50% of Estimated Project Costs). The application of a minimum quarterly duration (e.g. 16 or 8 quarters) results in an additional, unnecessary layer to the NPV test. It also results in a number of issues, such as;

The amount of unsold capacity on the network means that parties may be forced to reserve capacity they do not require:

- Example – a party requires incremental in 8 quarters due to no available capacity at the Entry Point, however due to the 16 minimum quarter duration they are required to reserve all of the unsold and incremental in an additional 4 quarters or fail the NPV test;*
- At an Aggregated System Entry Point this could result in the party holding more capacity than they have the capability to use, and also potentially locking out other industry parties from booking Long Term capacity in those quarters;*
- The above points do not result in efficient booking or allocation of entry capacity.*

Given industry is most likely moving to a cost allocation model the project costs and the capacity prices (which are not based on marginal costs) are completely independent of each other. Therefore having a minimum duration could result in parties over committing to the signal required:

- Example – a party is able to pass the NPV test by signalling capacity in 8 quarters, however by then forcing them to signal incremental capacity in 16 quarters means they are committing more than the 50% (sometimes in excess of 100%) of the project costs;*
- Any excess revenue committed is socialised across the network resulting in discriminatory charging.*

This could also lead to a process which is discriminatory and anti-competitive, as entry terminals have capacity prices which are not calculated based on marginal costs:

- Example – two terminals have different capacity prices (Point A lower than Point B), however both have requested the same amount of incremental capacity and both have the same project costs. Due to the minimum duration, Point B may have to commit a higher revenue amount than Point A when the incremental capacity released and investment costs are the same.*

KR then overviewed the 'Over recovery against NPV Trigger and Project Cost with minimum duration amounts' schematic and she drew attention to specific areas of interest regarding the 4 quarters. She also overviewed the 'Amount over recovered at NTS Entry Terminals for 16 and 8 quarter minimum durations' schematic.

CH said that the duration test was still needed to see the commitment factor as the investment needed to be socialised and to demonstrate how the commitment was going to be used.

Roddy Monroe (RM) asked if National Grid NTS would sign up to 4 quarters and CH said he would investigate this area, however he stated that National Grid NTS would be opposed to the Methodology Statement being moved to the UNC. BR asked if the methodology remained outside the UNC, what problem did that create? KR said that would mean the cost of incremental capacity would be a lot higher and it would not be cost reflective.

New Action 1101: National Grid NTS (CH) to provide evidence as to whether the Duration Test was still appropriate and required.

KR said she would further investigate the two proposals suggested by GJ and see if they would fit within the UNC and she would also look at other solutions with National Grid NTS in regards to if the £70m product values were still appropriate.

New Action 1102: National Grid NTS (CH & MM) to look at the estimated product values in the Model and provide a view if they are representative of the costs they will face.

RH reminded everyone that the timescales were very tight with this modification, as it was to be presented to the January 2019 Panel. BR said that despite this fact, that more detail was required as to how it would interface within the UNC Code, and that this needed to be explained within the modification to aid overall clarity.

Steve Pownall (SP) said that he had presumed that the change would be a contractual change only, with no system changes required, as the capacity was encompassed with the Gemini system, adding that if this was not the case, then Rough Order of Magnitude (ROM) costs would be needed.

New Action 1103: Xoserve (SP) and South Hook Gas (KR) to discuss if any systems changes would be required and if a ROM would be needed.

A further brief general discussion took place regarding what the potential impacts might be with the methodology being placed within the UNC and CH agreed to investigate these impacts and provide feedback.

New Action 1104: National Grid NTS (CH) to investigate the potential impacts and repercussions of removing the section of methodology and incorporating it into the UNC Code.

2.0 Initial Discussion

2.1. Issues and Questions from Panel

None raised.

2.2. Initial Representations

None raised.

2.3. Terms of Reference

The standard UNC Workgroup Terms of Reference will apply and is available at <https://www.gasgovernance.co.uk/mods>

3.0 Review of Actions

Action 1001: National Grid (MM) to provide more information on the background and original thinking for the 16 quarters and 2-year lead time rules.

Update: It was agreed the action should now be moved to the 0667 Workgroup and so will no longer feature within the Transmission Agenda items. **Carried forward**

Action 1002: National Grid (MM) to provide worked examples of how Project cost is used and recovered both in the current regime and in the new regime to aid understanding of the proposed changes. Worked examples to compare the current versus the EU codes approach to also be provided.

Update: : It was agreed the action should now be moved to the 0667 Workgroup and so will no longer feature within the Transmission Agenda items. **Carried forward**

4.0 Next Steps

RH confirmed that her expectation for the next meeting was to review the amended modification and the associated action updates.

5.0 Any Other Business

None.

6.0 Diary Planning

Further details of planned meetings are available at: <https://www.gasgovernance.co.uk/events-calendar/month>

Workgroup meetings will take place as follows:

Time / Date	Venue	Workgroup Programme
10:00 Thursday 06 December 2018	Elexon 350 Euston Road London NW1 3AW	Detail planned agenda items. <ul style="list-style-type: none"> • Amended Modification • Consideration of Business Rules • Review of Impacts and Costs • Review of Relevant Objectives • Consideration of Wider Industry Impacts • Consideration of Legal Text • Development of Workgroup Report

Action Table (as at 01 November 2018)

Action Ref	Meeting Date	Minute Ref	Action	Owner	Status Update
1101	01/11/18	1.0	National Grid NTS (CH) to provide evidence as to whether the Duration Test was still appropriate and required.	National Grid NTS (CH)	Pending
1102	01/11/18	1.0	National Grid NTS (CH & MM) to look at the estimated product values in the Model and provide a view if they are representative of the costs they will face.	National Grid NTS (CH & MM)	Pending
1103	01/11/18	1.0	Xoserve (SP) and South Hook Gas (KR) to discuss if any systems changes would be required and if a ROM would be needed.	Xoserve (SP) & South Hook Gas (KR)	Pending
1104	01/11/18	1.0	National Grid NTS (CH) to investigate the potential impacts and repercussions of removing the section of methodology and incorporating it into the UNC Code.	National Grid NTS (CH)	Pending