

Joint Office, relevant Gas
Transporters, Shippers and other
Interested parties

28 September 2018

UNC0667 - Inclusion and Amendment of the Entry Incremental Capacity Release Net Present Value test in the Uniform Network Code: Decision on request for urgent status

On 6 September 2018 the Joint Office received a request from South Hook Gas Company Ltd (South Hook Gas, the Proposer) to make the status of Modification UNC0667 'Inclusion and Amendment of Entry Incremental Capacity Release Net Present Value (NPV) test in Uniform Network Code (UNC) 'urgent'. Following consideration of the request that UNC0667 follows urgent modification procedures, we¹ have decided not to grant urgent status. This letter outlines the background to the request and provides further detail on our decision.

Background

UNC0667 is seeking to codify and revise the specific aspect of the Entry Capacity Release Methodology Statement (ECRM) which sets out the conditions under which National Grid Gas Transmission (NGGT) reserves and releases entry capacity.

Capacity is reserved via the Planning and Advanced Reservation of Capacity Agreement (PARCA) process. A PARCA is a bilateral contract allowing a National Transmission System (NTS) user to secure entry and/or exit capacity directly from NGGT. A PARCA allows the NTS user to reserve capacity while they develop their project, and before they are allocated that capacity (i.e. before they buy that reserved capacity). A PARCA request triggers a three-stage process - from NGGT's assessment of how and when it will deliver the requested capacity, obtaining planning approvals, and work to deliver the capacity.

The Gas Transporter Licence² (the Licence) requires NGGT to have a number of methodology statements in place that set out how capacity is released, offered for sale, and substituted across the NTS (the Capacity Methodology Statements). The Licence, rather than the UNC, sets out the requirement for, and governance of, the Capacity Methodology Statements. For this reason, changes to the methodology statements are not subject to the

¹ Ofgem is the Office of the Gas and Electricity Markets Authority. The terms 'Ofgem', 'the Authority', 'we', 'our' and 'us' are used interchangeably in this letter.

² Special Condition 9A and 9B

UNC governance process, and instead follow the governance process set out in the Licence.³

The methodology statement for the release of Entry Capacity (the ECRM) sets out the circumstances under which NGGT will accept applications for NTS Entry Capacity, and the level of firm financial user commitment required from applicants to justify the reservation of entry capacity. In some cases, the reservation of NTS entry capacity could result in the release of 'incremental' capacity (capacity over and above NGGT's licence-based 'obligated'⁴ levels). Projects seeking to reserve incremental entry capacity must pass two net present value (NPV) tests - one at the end of the PARCA Phase 1, using indicative prices, and a second at the end of PARCA Phase 2 using updated prices. The NPV tests are contained in the ECRM.

South Hook Gas (the Proposer) is currently undertaking the PARCA Phase 1 process to reserve incremental entry capacity at the Milford Haven Entry Point. In its modification proposal (UNC0667), the Proposer states that the project cannot pass the PARCA Phase 1 NPV test without reserving all of the unsold capacity at the relevant entry point in numerous summer quarters. The Proposer states that the current "NPV methodology is unclear and unfit for purpose in the context of a PARCA application..." The Proposer notes that the current NPV process would result in South Hook Gas reserving more capacity than it can physically use and result in revenues to NGGT in excess of the Estimated Project Value.

To attempt to mitigate these issues, UNC0667 seeks to insert the NPV test into the UNC, and subsequently make changes to the mechanics of the NPV test.

The Proposer considers that UNC0667 should be treated urgently since it is linked to an imminent date-related event and without the above changes, there is a "real likelihood of significant commercial impact upon South Hook Gas in its capacity as a Shipper", primarily that it will not be able to successfully complete its current PARCA application by the end of October.

Our decision on urgency

In reaching our decision not to grant urgent status we have considered the Proposer's justification for urgency in respect of the modification proposal. We have assessed the request against the urgency criteria set out in Ofgem's published guidance.⁵

Our current view is that an urgent modification should be linked to an imminent issue or a current issue, that if not urgently addressed may cause:

- a significant commercial impact on parties, consumers or other stakeholder(s); or
- a significant impact on the safety and security of the electricity and/or gas systems;
- Or, a party to be in breach of any relevant legal requirements.

In considering whether to grant UNC0667 urgent status, we have noted the Proposer's view of the potential commercial impact.

We note that the NPV test underpins investment decisions, socialisation of investment costs and ultimately NGGT allowed revenues. The NPV test seeks to ensure that there is a sufficient signal from entry capacity auctions to justify the need for investment in, and future use of, capacity above obligated levels. In that sense, we expect the NPV test will usually imply a level of commercial impact on the NTS user. Such an outcome does not *necessarily* warrant change to the underlying test.

³ Special Condition 9A.7 and 9B.9

⁴ The levels that, under its licence, NGGT are obliged to make available to NTS users

⁵ Ofgem Guidance on Code Modification Urgency Criteria

(https://www.ofgem.gov.uk/system/files/docs/2016/02/urgency_criteria.pdf)

We acknowledge that the Proposer considers that this is an urgent issue that should be addressed without further delay. However, the fact that a matter may be considered important does not equate to the need for a modification proposal to be treated as urgent. We acknowledge that the application of the NPV test under the PARCA process can, by its nature, have a commercial impact on parties. However, our view is that the Proposer has not adequately demonstrated a case for why the issue must be urgently addressed at this time. We note, among other things, that the PARCA process and its timings have been in place for some time and are known by relevant parties. As such, we anticipate any user would factor this into their internal processes in considering whether, and when, to raise a code modification proposal.

Furthermore, we consider a proposal to bring the NPV test into the code, and change the mechanics of it, to be a matter that warrants workgroup discussion and thorough assessment. The timetable to be followed by any modification proposal (whether granted urgency or not) needs to ensure, as far as possible, that there is sufficient opportunity for robust analysis to be undertaken. Importantly, this analysis needs to assess whether the proposal better facilitates the relevant code objectives, in order that the Panel can make a robust recommendation to us.

In this context, we note the requirements set out by existing governance arrangements in the Licence for changes to the methodology statements. Generally, we would expect a comparable degree of assessment to accompany proposed changes to aspects of the methodology statements proposed to be included within the UNC. It is unclear this can be completed in the proposed timeframe.

For the avoidance of doubt, in not granting the request for urgency, we have made no assessment of the merits of the proposals and nothing in this letter in any way fetters our discretion in respect of these proposals.

If you have any queries or comments in relation to the issues raised in this letter, please contact david.oneill@ofgem.gov.uk in the first instance.

Yours faithfully,

Andrew Burgess
Duly authorised on behalf of the Authority