NTSCMF / Sub Group - One page note on the helpfulness of Locational Signals in Capacity Prices

Some key terms in relation to locational signals:

Term	Detail
RPM	The Reference Price Methodology is the means by which the Capacity prices are produced for both Entry and Exit. This will include any additive components or administered adjustments.
LRMC	Long Run Marginal Cost. This is the current underlying RPM used in the calculation of Entry and Exit Capacity prices. Whilst there are different approaches in Entry and Exit as to how secondary adjustments are applied, the underlying LRMC principles are there in both. The LRMC approach is an investment focused methodology where the intention is to have strong locational signals to facilitate decision making.
CWD	Capacity Weighted Distance. An alternative RPM to the LRMC (or Virtual Point) approach. Whilst there are different prices based on geography, the strength of the locational signal, or intent, is less than in the LRMC as a principle.
PS	Postage Stamp method. Another alternative RPM that has no locational distribution, one price paid at all points to which charge is applicable.

Background to current reference price methodology

The current LRMC Model is designed based on a Long Run Marginal Cost model that is linked to cost of investment. As part of the model the overall distance gas is presumed to travel to match supplies to demand is optimised. Based on the distance, using cost components a price is produced. Within these prices it is meant to provide meaningful locational signals about where to locate on the network. Both Entry and Exit use the LRMC approach then apply a series of adjustments that dampen the strength of these signals (e.g. average LRMC for Entry and Revenue adjustment for Exit).

Use of Locational Signals

Locational signals would also be an influence in the Capacity weighted distance methodology, however as the CWD is more a usage based model than an investment focused model there is less of an underlying emphasis on the locational signal driving the prices. Generally, there will be some locational influence on prices (except for a Postage Stamp approach) however they will have varying degrees of influence dependent on the RPM.

Summary of Discussion

- Depending on the view of the payable prices for capacity where the influence of discounts may come into play, parties may place less importance on locational signals in capacity prices;
- Were locational signals intended to drive behaviours?
    - The perception is that the methodology should drive behaviour but in reality this is not the case;
- Locational signals, from a shipper point of view, are not necessarily a big factor in influencing investment decisions when incorporating the impact of prices;
- Some parties have stated Locational Signals were not important to them;
- If Long Term prices were more predictable locational signals could be more useful in decision making. The unpredictability of Long Term prices is considered unhelpful.
- Given the change over time, the focus of the charges has become more of revenue recovery, with the noticeable change towards commodity over capacity, reducing locational impacts.

Conclusion

The use of the locational signals to Network Users is considered limited and not a significant factor in decision making.