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# Capacity Methodologies Review 2019

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# Methodology Review update

It should be noted that NG has produced a supporting NPV tool which models the new proposed test. This is available on the website alongside the rest of the consultation material.

As a reminder - the preliminary consultation will be open until 15<sup>th</sup> Feb.

<https://www.nationalgridgas.com/capacity/capacity-methodology-statements>

# **NG Proposal & SHG proposal – what's different?**

## **Difference in Scope**

- 1. Project Cost determination.**

## **Difference in Rules**

- 1. NPV test for substitution.**
- 2. 16 quarter minimum duration rule.**
- 3. Locking in the Project Value at Reservation.**
- 4. Discounting on revenue from the premium.**

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**Difference 1 –  
substitution  
test**

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# Substitution

**NG is proposing that substitution automatically passes the NPV test.**

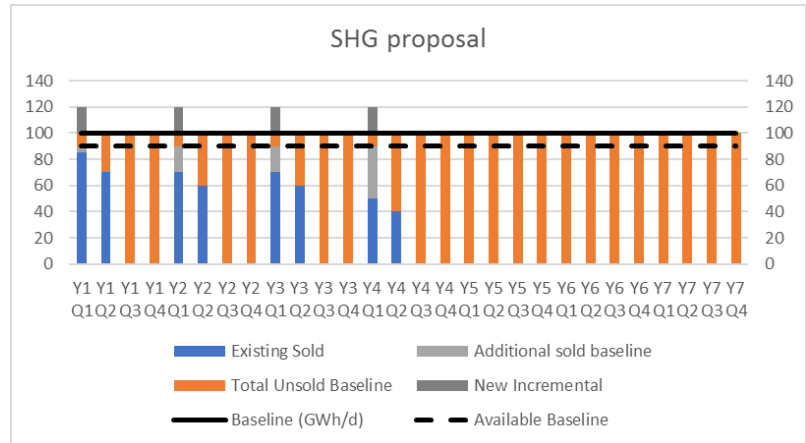
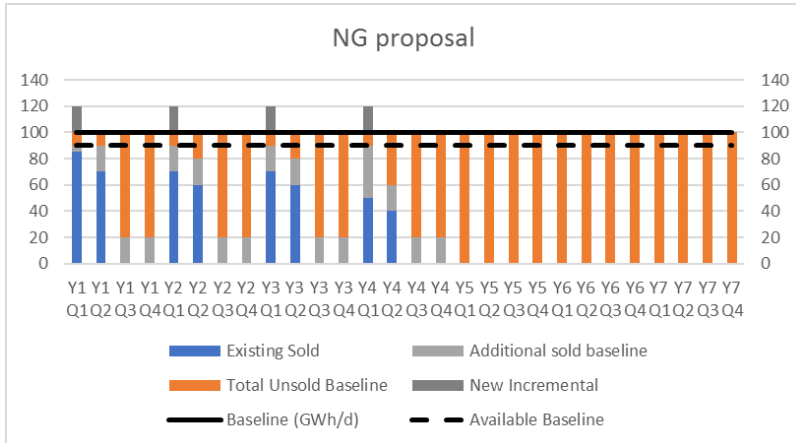
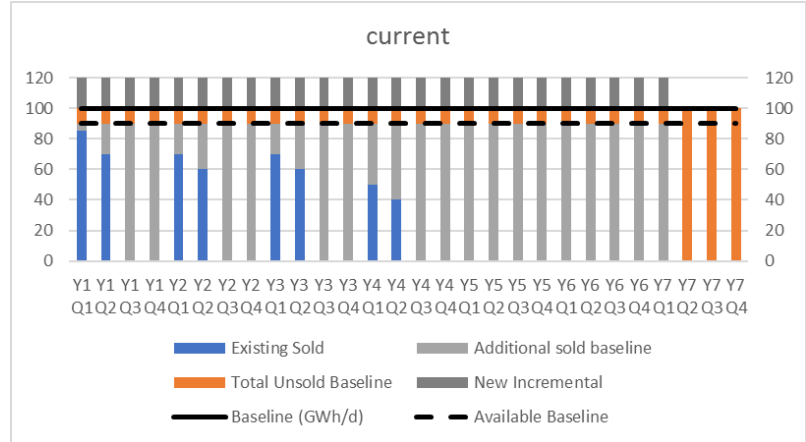
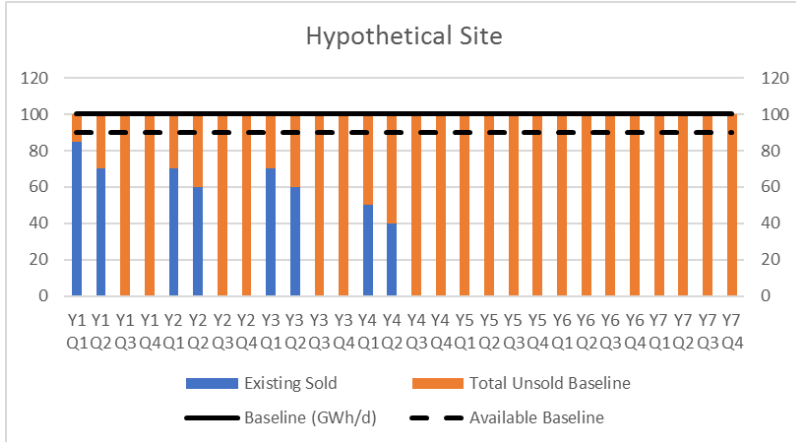
- **This outcome naturally falls out of the new proposed way to calculate project cost.**
- **Substitution will still be possible via QSEC, subject to the 16 quarter minimum duration rule.**

**Proposal 667 has made no explicit proposal with regards to substitution (or project cost).**

- **We would invite further clarity around how the revised NPV test will work with QSEC.**

# **Difference 2 – minimum duration rule**

# Comparison of min. required booking profiles for 20 units incremental



# 16 quarter (out of 32) rule

**This rule is contained within the ECR, and also within the UNC** (*UNC text below*)

*B1.17.7 Reservation of the NTS Capacity will occur where:*

*(c)(ii) [NG] determine that no net present value test is required, a quantity of Quarterly NTS Entry Capacity has been requested by the PARCA Applicant in at least 16 Quarters within a 32 Quarter consecutive period.*

- Rule applies to both existing capacity and substitution solutions.
- We believe that existing capacity and substitution solutions should be treated the same way on principle – substitution is still utilising existing capacity, just from another point on the network.

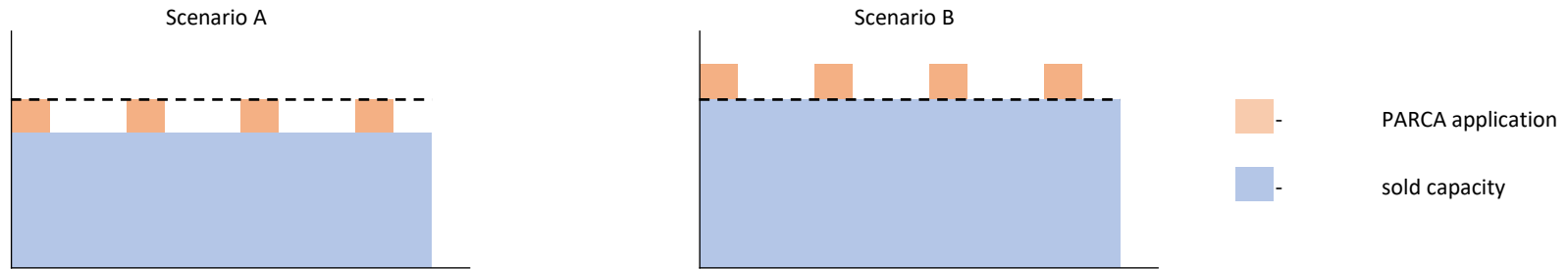


# Substitution and existing capacity

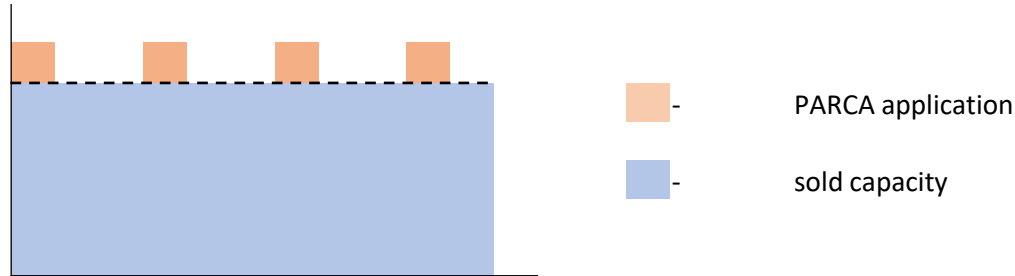
**Counterfactual: if a minimum duration (16 qrtr) rule applied to existing capacity and not substitution, it enables odd outcomes.**

Scenario A – Application for 4 quarters. Solution is existing capacity - **x**

Scenario B – Application for 4 quarters. Solution could be substitution - **✓**



# Substitution and Incremental capacity



**We believe that any criteria applied to substitution should also be applied to obligated (funded) incremental to ensure the methodology points to efficient and/or economic outcomes.**

**In the above scenario an incremental amount is signalled. If the minimum duration rule is applied to substitution but not obligated incremental:**

- Funded incremental solutions would be permitted;**
- Substitution solutions would not be permitted.**

# Summary

**Our proposals reduce the amount of unsold baseline that needs to be purchased under the NPV test significantly (compared to the old test), but the minimum duration PARCA rule provides a natural floor below which we can not go without creating the potential for illogical or uneconomic outcomes.**

**Existing Capacity < Substitution < Obligated Incremental**

**We are proposing to align the duration rule across all potential solutions for PARCAs. This gives assurance that the most economic & efficient solution will be achieved.**

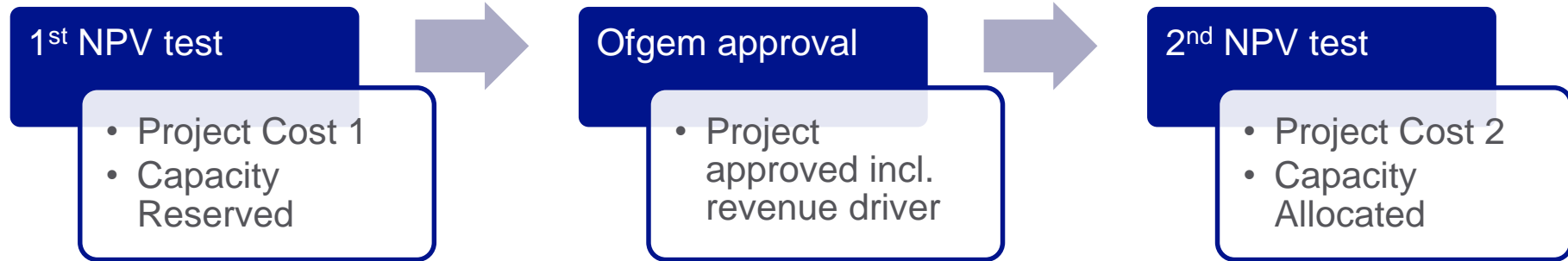
**This also brings simplicity i.e. provides an upfront clear rule for applicants, that is not going to change throughout phase 1 depending on what the solution is, and depending on whether more capacity gets sold.**

**QSEC – for parity then the 16 quarter rule can also be applied to substitution under QSEC. No financial test is required for QSEC.**

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**Difference 3 –  
locking in  
project cost**

# Relevant key parts of PARCA Process



**The current arrangement is that Project Cost 2 uses the prevailing estimate available at the time. NG have not proposed any change here, but want to discuss the options.**

**Proposal 667 proposes to lock in Project Cost 1, with adjustment for inflation.**

# Determining Project Cost 2

There will inevitably be a difference between the project cost at the time of the 2<sup>nd</sup> test, compared to the project cost estimate at the 1<sup>st</sup> test.

Main options for determining Project Cost 2 are outlined below:

1. Use the prevailing (known) project cost for the 2<sup>nd</sup> test. This upholds the principle that the applicant should fund at least 50% of the project cost.
2. Use the (initial project cost 1+ inflation) for the 2<sup>nd</sup> test. This gives greater certainty earlier in the process to the applicant of the cost threshold they must pass.
3. Use the prevailing (known) project cost for the 2<sup>nd</sup> test subject to a cap/collar of +/- [20]% compared to project cost 1.

# Transition Rule

**Is a separate rule required for any 'in-flight' PARCAs?**

**If option 2 or 3 is used then there is no real need for any additional transition rule.**

**If option 1 is used then there is more of a case for creating a separate transition rule e.g. option 2 or 3.**

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# Premium Calculation

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# Discounting revenue from the premium

Premium revenue is non-discounted in modification proposal 667. (50% threshold will not be passed once discounting is applied).

Premium revenue will be discounted under NG proposals.

(note: in the current version of NG's NPV tool on the website the premium revenue is not discounted, but this will be amended for the next version).

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**Timeline**

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# Timetable 2018/2019

Preliminary Consultation currently open for ~4 weeks. Closes out 15<sup>th</sup> Feb.

