







UNC Modification		At what stage is this document in the process?
<h1>UNC 0XXX:</h1> <h2>Inclusion and Amendment of Entry Incremental Capacity Release NPV test in UNC</h2>		<div style="display: flex; flex-direction: column; gap: 5px;"> <div style="border: 1px solid green; background-color: #28a745; color: white; padding: 2px; display: flex; align-items: center; justify-content: center;"> <span style="font-weight: bold; font-size: 1.2em;">01</span> Modification         </div> <div style="border: 1px solid #17a2b8; padding: 2px; display: flex; align-items: center; justify-content: center;"> <span style="font-weight: bold; font-size: 1.2em;">02</span> Workgroup Report         </div> <div style="border: 1px solid #9932cc; padding: 2px; display: flex; align-items: center; justify-content: center;"> <span style="font-weight: bold; font-size: 1.2em;">03</span> Draft Modification Report         </div> <div style="border: 1px solid #fd7e14; padding: 2px; display: flex; align-items: center; justify-content: center;"> <span style="font-weight: bold; font-size: 1.2em;">04</span> Final Modification Report         </div> </div>
<p><b>Purpose of Modification:</b> This modification seeks to insert the Net Present Value test required for Non-IP Entry Incremental Capacity Release into UNC, and amend the mechanics of the test to ensure that it works effectively with the current GB system.</p>		
	<p>The Proposer recommends that this modification should be:</p> <ul style="list-style-type: none"> <li>treated as urgent and should proceed as such under a timetable agreed with the Authority</li> </ul> <p>This modification will be presented by the Proposer to the Panel on 10 September 2018. The Panel will consider the Proposer's recommendation and determine the appropriate route.</p>	
	<p>High Impact: None</p>	
	<p>Medium Impact: None</p>	
	<p>Low Impact: Shippers, National Grid NTS</p>	

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4	Code Specific Matters	11	 0121 288 2107
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Timetable		Systems Provider: Xoserve	
<b>The Proposer recommends the following timetable:</b>		 <a href="mailto:UKLink@xoserve.com">UKLink@xoserve.com</a>	
Panel recommendation on urgency	10 September 2018	Other: Insert name	
Ofgem decision on urgency	14 September 2018	 email address	
Workgroup 1	21 September 2018	 telephone	
Workgroup 3	28 September 2018		
Workgroup 3	4 October 2018		
Consultation open	8 October 2018		
Consultation closes	15 October 2018		
Final Modification Report available for Panel	16 October 2018		
Modification Panel recommendation	18 October 2018		
Authority Decision	26 October 2018		

## 1 Summary

### What

For Incremental Capacity to be reserved and allocated as part of the Planning and Advanced Reservation of Capacity Agreement (PARCA) process a series of net present value (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 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 it signals 50% of the Estimated Project Value.

South Hook Gas Company Ltd. ("South Hook Gas") 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. South Hook Gas understands that this PARCA application is the first to be processed in respect of incremental NTS entry capacity.

The methodology for the NPV test is currently defined in the Entry Capacity Release Methodology (ECRM) Statement rather than the UNC. The NPV methodology is unclear and unfit for purpose in the context of a PARCA application in respect of incremental entry capacity. This is 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<sup>1</sup>.

Therefore, this Modification Proposal seeks 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.

### Why

There is a lack of clarity over the extent of the signalling obligation under the NPV test, which creates uncertainties as to the required threshold for compliance. As noted above, this is in part attributable to the potential move from a fixed to a floating price regime and a change to the charging methodology. However, the prescribed process as recently confirmed to South Hook Gas requires the PARCA applicant to signal Incremental Capacity for the purposes of the NPV test by acquiring excessive amounts of unsold capacity (as well as incremental capacity) at the relevant Entry Point, due to the unconstrained nature of the network and the resultant general reliance on short term capacity products. The required compliance threshold is so onerous that maintenance of the present approach may have the unintended consequences referenced above in respect of PARCA applications and project investment.

The South Hook Gas PARCA application was submitted on 24<sup>th</sup> April 2018 and the Phase 1 PARCA Works are forecast to complete in October 2018. Despite signalling incremental capacity in the required number of quarters, South Hook Gas is not able to pass the PARCA Phase 1 NPV test without reserving all the unsold capacity at the Milford Haven ASEP in numerous summer quarters.

If this prescribed approach is adopted here, with South Hook Gas acquiring all unsold and incremental capacity over the required period, there will be a number of consequences, for which there does not seem to be any economic or technical justification, including:

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<sup>1</sup> Further information can be found at <https://www.gasgovernance.co.uk/0621>

1. South Hook Gas having to reserve more capacity that it can physically use (including once the incremental capacity is delivered by NGG);
2. South Hook Gas reserving capacity that would lead to revenues to NGG well in excess of the Estimated Project Value;
3. Dragon LNG no longer being able to purchase long term capacity in those quarters (only the 95GWh/day that is withheld for short term could be available); and
4. A commitment to higher revenues than necessary because of changes to both Estimated Project Value and prices immediately prior to the second NPV test if there is a restriction on changing the incremental capacity profile

The current ECRM methodology is not clear on whether there is an opportunity to reprofile the incremental capacity ahead of the second NPV test (end of PARCA phase 2) and if the applicant is deemed to have failed the second NPV test (i.e. by signalling less than 50% of Estimated Project Value) then NGG can terminate the PARCA application, resulting in the PARCA termination fee having to be paid by the applicant and/or potential disruption and delay in the context of a larger project.

As noted above, this modification Proposal seeks to insert the NPV tests and their methodology into the UNC. The NPV tests are currently defined in the ECRM Statement, which is not subject to the UNC code governance process. Therefore, if the NPV tests are not inserted into the UNC, they cannot be modified without a full review of the methodology statements. The UNC would be the more appropriate location for the NPV tests to allow for a clear statement of the NPV tests as amended and the provision of a more efficient review and refinement process to address both the issues noted above and future required changes, ensuring the tests remain fit for purpose.

## How

This modification Proposal seeks to insert the NPV tests into the UNC TPD, Section B to allow them to be modified via the UNC governance process, and subsequently change the mechanics to allow for:

- An “Incremental Capacity Premium” to be applied should the estimated reference price not generate sufficient revenues for a positive NPV test outcome. This concept is based on the IP Mandatory Minimum Premium that is part of the Incremental Capacity Release at Interconnection Points within UNC, European Interconnection Document, Section E. The Incremental Capacity Premium is an additional quantity that is added to the applicable payable price, calculated to be the minimum value required to allow the NPV test to be passed in the case where the allocation of all offered incremental capacity at the estimated reference price would not generate sufficient revenues for a positive NPV test outcome.
  - o For example, if capacity totalling £50m on a NPV basis is required to be signalled but only £30m of Incremental Capacity sales are available using the estimated reserve price, then the additional £20m required would be divided by the Incremental Capacity denominator to create the Incremental Capacity Premium in p/kWh/d, which is then applied on top of the reserve price.
- A minimum of 8 quarters of incremental capacity to be signalled out of the 32 quarter period covered in the PARCA NPV test. This is to guarantee there is a sustained incremental signal to ensure efficient investment in the system.
- Submission of incremental capacity profile ahead of the second NPV test at the end of PARCA Phase 2 as per Phase 1 NPV test, to either avoid unnecessary termination of the PARCA application or excessive revenue being collected. This also provides an opportunity for the Incremental Capacity Premium to be recalculated. The Incremental Capacity Premium is fixed at this point and paid in addition to any capacity charges as they become due.

- The project value for the remaining duration of the PARCA application to be fixed at the time of the 1<sup>st</sup> NPV test (at the end of PARCA Phase 1).

## 2 Governance

### Justification for Urgency

This modification is proposed as Urgent pursuant to the UNC Modification Rules, Section 10 of the UNC General Document Part IV and as per the following consideration criteria in the Urgent UNC Modification Guidance Note<sup>2</sup>;

- the Proposal is linked to an imminent date related event;
- there is a real likelihood of significant commercial impact upon South Hook Gas in its capacity as a Shipper if the proposed modification is not classified as Urgent

### Imminent Date Related Event

The deadlines driving the urgency of this Proposal are (1) the expiry date of PARCA Phase 1 and (2) the expected timing for the upstream project's final investment decision.

The South Hook Gas PARCA application was submitted on 24<sup>th</sup> April 2018. On the basis of the PARCA methodology it is expected that PARCA Phase 1 would conclude around 27<sup>th</sup> October 2018.

If this modification Proposal is not implemented before the expiry of PARCA Phase 1 in respect of the South Hook Gas PARCA application, South Hook Gas may not have the financial capability to acquire the prescribed unsold capacity and thereby pass the Phase 1 NPV test that is to promptly follow the expiry of Phase 1 as part of the entry into a Reservation Agreement for the purposes of Phase 2. This could result in the PARCA project stalling or even being cancelled. Therefore, South Hook Gas proposes that this modification Proposal be implemented as a matter of urgency prior to such expiry date.

As noted above, the South Hook Gas PARCA application was submitted as part of a potential LNG project that is intended to deliver LNG (potentially from the Golden Pass facility in the USA or another source) to the South Hook terminal. Any delay in the PARCA process (and, in particular, any cancellation of the PARCA process) will impact on the final investment decision timing for this project and the delay may cascade through other project timetables. It is also noted that the current prescribed financial commitment that would be required to pass the NPV test would need to be factored into overall project economics. This uncertainty and onerous financial commitment would seem to disincentivise potential investment in the GB gas sector and have a negative impact on security of natural gas supply for GB.

There has been ongoing engagement between South Hook Gas and NGG on this matter and there is agreement that addressing these issues by way of an urgent UNC modification is the only option if the above deadlines are to be met, as the timeline associated with a non-urgent modification is unlikely to allow for an Authority decision and implementation within the PARCA and project timescales.

### Commercial Impact on South Hook Gas

Further information on the financial commitment required and the resultant commercial impact upon South Hook Gas can be found in section 3. However, at a high level, the revenues recovered from South Hook Gas

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<sup>2</sup> <https://www.gasgovernance.co.uk/sites/default/files/ggf/ApprovedUrgentProposalsGuidelines.pdf>

would be in excess of 3 times the amount of incremental revenue required to cover 50% of the Estimated Project Value and would result in signalled revenues higher than the total Estimated Project Value. When considering any future methodology changes this amount is also likely to increase and add additional uncertainty to any investment project.

### Requested Next Steps

This modification Proposal should:

- be treated as Urgent and should proceed as such under a timetable agreed with the Authority.

## 3 Why Change?

### Background to Incremental Capacity NPV Test

Incremental Capacity is additional capacity that is made available above the prevailing level of Obligated Entry Capacity. For the Incremental Capacity to be reserved and subsequently allocated, a NPV test needs to be passed to ensure user commitment and provide sufficient assurances that the costs of any incremental investment associated with PARCA Works are recovered. The revenues required to be recovered are from the Estimated Project Costs, which are calculated through the Long Run Marginal Cost methodology, and 50% of this must be collected for the NPV test to be passed. The mechanics of the NPV test are included within the ECRM statement<sup>3</sup>.

The ECRM was first issued in 2002 and included the current NPV test. Since then there has been not been a comprehensive review of the NPV test<sup>4</sup> (other than project costs and price steps which have been changed alongside charging methodology developments). The NPV test was implemented when there was an expectation that capacity would be acquired on a long term basis, via the QSEC auctions, allowing for incremental capacity to be signalled. Since 2002, capacity booking behaviour has moved almost entirely towards the purchase of short term products which are discounted (up to 100% for within day and interruptible products). This has caused difficulties for incremental capacity to be signalled within the current methodology.

Chart 1 shows the amount of sold and unsold capacity that is available within the Long Term auctions at the current time and incremental capacity would only be available without purchasing any unsold capacity in 5 of the 32 quarters (i.e. where sold amounts are equal to LT baselines). Chart 2 indicates, in green, the amount of unsold capacity that would need to be reserved for incremental capacity to be signalled using the Price Step 7 Estimated Project Value of £140m. At the highest current price step for Milford Haven (which would be required in this example) the unsold capacity would cost £211m with the £70m cost of incremental capacity on top of this. Unsold capacity that is purchased does not contribute to the NPV test despite being priced as such (noting that this capacity would also be subject to the same price step as incremental capacity). This would result in total costs of £281m which is significantly higher than the required incremental revenue signal (NPV test) of £70m, and even the total Estimated Project Value of £140m. In addition, it would also result in one of the parties at the ASEP holding all the Long-Term capacity rights at the ASEP for the single purpose of passing the NPV test meaning other participants would be unable to purchase Long-Term products at the ASEP. It is also worth noting that 855GWh/day unsold capacity required to be purchased is more technical capacity than either of the current individual Milford Haven Entry Terminals can utilise, even when the Incremental Capacity is brought on-line.

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<sup>3</sup> <https://www.nationalgrid.com/uk/gas/charging-and-methodologies/methodologies>

<sup>4</sup> Entry Capacity Release Methodology v4, Document Revision History

Chart 1: Sold Capacity and Milford Haven ASEP

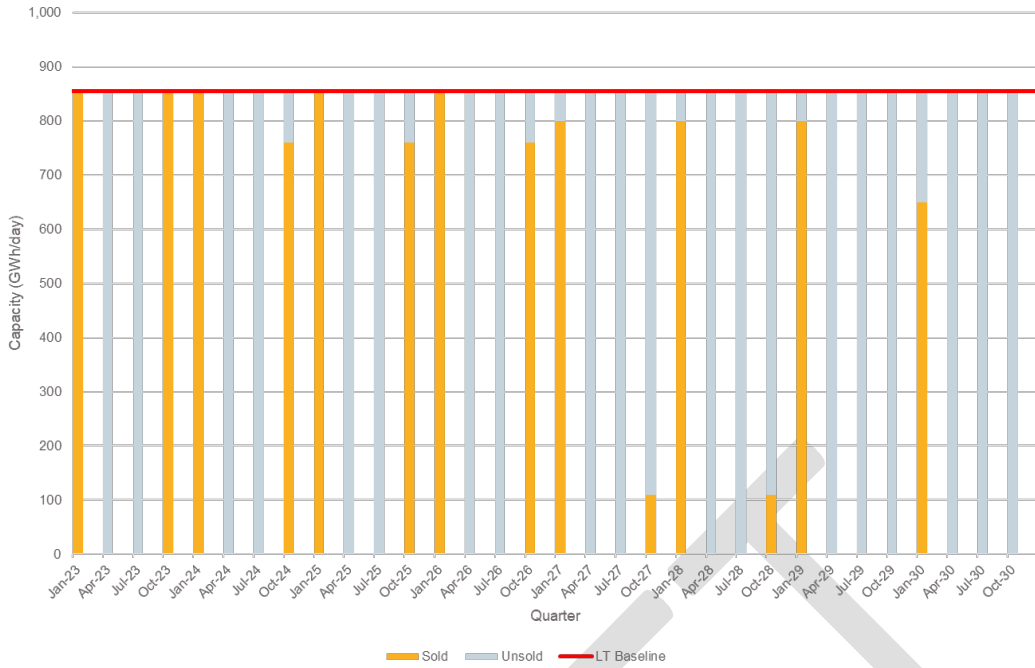
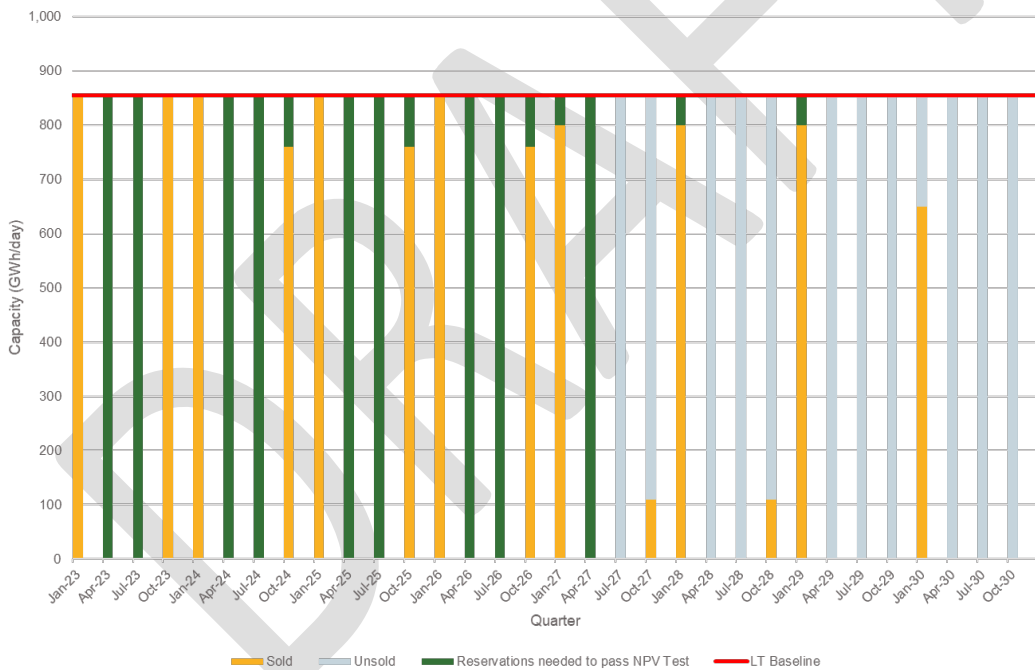


Chart 2: Unsold Capacity Required to Pass NPV Test at Milford Haven ASEP



The issue is not exclusive to the Milford Haven ASEP and occurs across many of the Entry Points on the network. Chart 3 and Chart 4 show similar issues for the Isle of Grain Entry Point. Using the same scenarios (Estimated Project Value from Price Step 7 and using the highest price step for Isle of Grain) the combined cost of unsold capacity (£21.8m) and incremental capacity (£17.5m) is greater than the total Estimated Project Value (£33.5m).

Chart 3: Sold Capacity and Isle of Grain

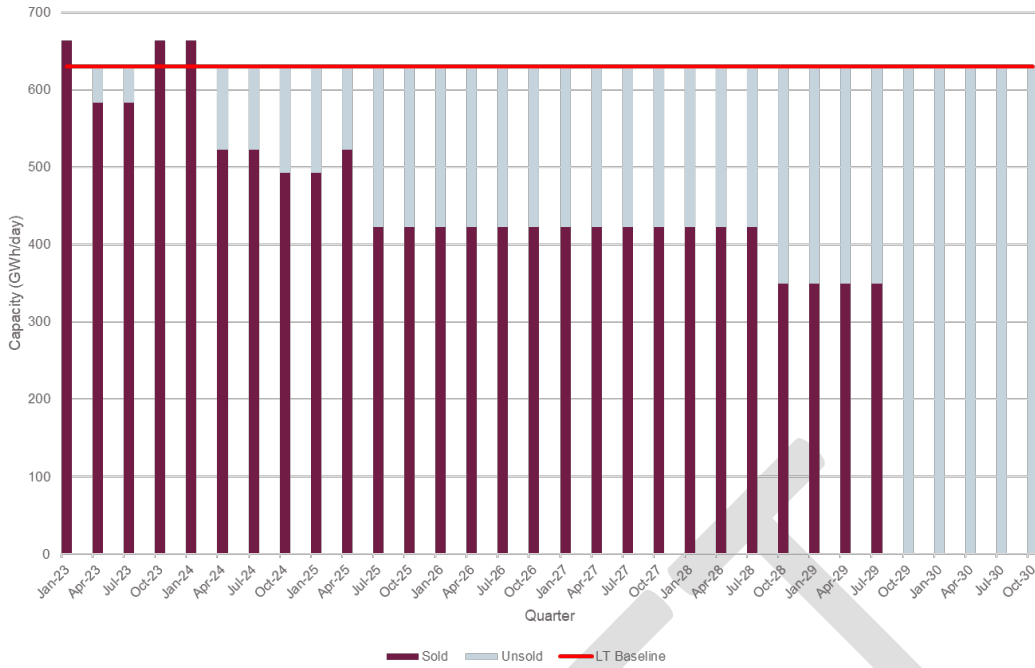
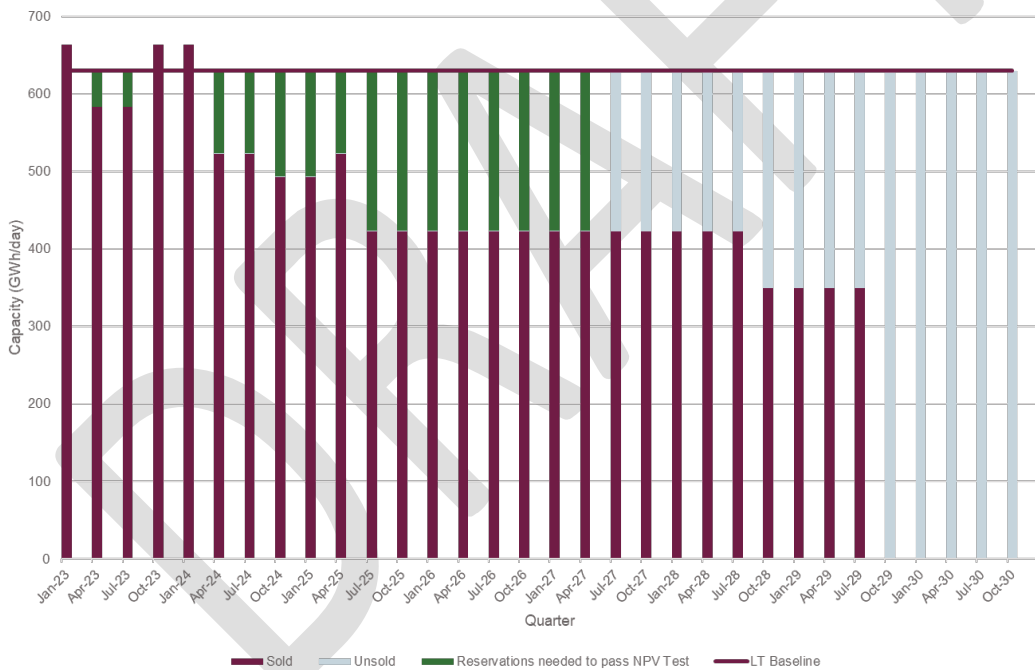


Chart 4: Unsold Capacity Required to Pass NPV Test at Isle of Grain



Both LNG terminals are in the top 5 Entry Points in terms of Long Term bookings vs total baseline available<sup>5</sup>, which can be seen in Table 1. Given the difficulties to pass the test at both LNG Entry Points it is fair to assume that most of other Entry Points on the network would face the same issue if attempting to signal Incremental Entry Capacity.

<sup>5</sup> From 1<sup>st</sup> January 2023 to 31<sup>st</sup> December 2030



Table 1

Entry Point	Sold Capacity (Gwh/day)	Total Available (GWh/day)	Percentage Purchased
Cheshire	16,886	17,366	97%
Hole House Farm	5,673	9,491	60%
Isle of Grain	12,605	22,390	56%
Milford Haven	8,970	30,400	30%
Caythorpe	810	2,880	28%
Easington	8,927	45,029	20%
Bacton	2,986	15,539	19%
Fleetwood	3,107	20,800	15%
Teesside	1,178	14,243	8%
Garton	980	13,440	7%
Hatfield Moor (Storage)	44	810	5%
Hornsea	206	7,459	3%
Barrow	128	10,880	1%
St. Fergus	151	53,462	0%
Theddlethorpe	0	19,542	0%
Glenmavis	0	3,168	0%
Partington	0	6,880	0%
Avonmouth	0	5,738	0%
Dynevor Arms	0	1,568	0%
Hatfield Moor (Onshore)	0	810	0%
Wytch Farm	0	106	0%
Burton Point	0	2,352	0%
Barton Stacey	0	5,523	0%
Canonbie	0	6,400	0%

### Why the NPV tests should be put into UNC

The NPV tests are currently defined in the ECRM, which is not subject to the UNC governance process. Therefore, if the NPV tests are not inserted into the UNC, they cannot be modified without a full review of the methodology statements. The UNC would be the more appropriate location for the NPV tests to allow for a clear statement of the NPV tests as amended and the provision of a more efficient review and refinement process to address both the issues noted above and any future required changes, ensuring the tests remain fit for purpose. Given the current review of the charging regime (UNC Modification 0621) and the requirement for future methodologies to be consulted on every 5 years (as per EU TAR)<sup>6</sup>, this would also allow for more timely updates. The insertion of the NPV tests into the UNC is consistent with the charging methodology which has been previously inserted into code (UNC Section Y), along with other charging topics (such as the Optional Commodity Charge).

### Urgency request and impacts should the change not be made

This modification is proposed as Urgent pursuant to the UNC Modification Rules, Section 10 of UNC General Document Part IV on the basis the Proposal is linked to an imminent date related event and a real likelihood of

<sup>6</sup> Article 27, Paragraph 5. <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32017R0460&from=EN>

significant commercial impacts upon South Hook Gas in its capacity as a Shipper if the proposed modification is not classified as Urgent.

The deadlines driving the urgency of this Proposal are (1) the expiry date of PARCA Phase 1 (on or about 27 October 2018) and (2) the expected timing for the upstream project's final investment decision.

If the modification Proposal is not implemented before the expiry of PARCA Phase 1 in respect of the South Hook Gas PARCA application, South Hook Gas may not have the financial capability to acquire the prescribed unsold capacity and thereby pass the Phase 1 NPV test that is to promptly follow the expiry of Phase 1 as part of the entry into a Reservation Agreement for the purposes of Phase 2. This could result in the PARCA project stalling or even being cancelled. Therefore, South Hook Gas proposes that this modification Proposal be implemented as a matter of urgency prior to such expiry date.

As noted above, the South Hook Gas PARCA application was submitted as part of a potential LNG project that is intended to deliver LNG (potentially from the Golden Pass facility in the USA or another source) to the South Hook terminal. Any delay in the PARCA process (and, in particular, any cancellation of the PARCA process) will impact on the final investment decision timing for this project and the delay may cascade through other project timetables. It is also noted that the current prescribed financial commitment that would be required to pass the NPV test would need to be factored into overall project economics. This uncertainty and onerous financial commitment would seem to disincentivise potential investment in the GB gas sector and have a negative impact on security of natural gas supply for GB.

Further information on the financial commitment required and the resultant commercial impact upon South Hook Gas can be found in section 3. However, at a high level, the revenues recovered from South Hook Gas would be in excess of 3 times the amount of incremental revenue required to cover 50% of the Estimated Project Value and would result in signalled revenues higher than the total Estimated Project Value. When considering any future methodology changes this amount is also likely to increase and add additional uncertainty to any investment project.

## Impacts

South Hook Gas believes that this Modification is relatively simple and builds on principles that have been previously used. For example previous methodologies (e.g. capacity charging and the optional commodity charge) have been inserted into UNC to allow for amendments via the Code Governance Process, which is a robust process allowing for development and implementation of code modifications. The Incremental Capacity Premium is based on the Mandatory Minimum Premium which is a concept which is set out in EU TAR and is used for Interconnection Point Incremental Capacity Release in GB.

There are no resultant impacts on other users' charges as these alterations only ensure that the Incremental Revenue signal can be achieved as efficiently as possible based on the current usage of the NTS, as was initially intended by the test. The Incremental Capacity Premium also provides the industry with a degree of certainty that the PARCA Applicant is able to provide the required commitment to the project, given that the Incremental Capacity Premium will be fixed and applied in addition to the reserve price for any Incremental Capacity.

## 4 Code Specific Matters

### Reference Documents

Entry Capacity Release Methodology Statement –

<https://www.nationalgrid.com/sites/default/files/documents/Entry%20Capacity%20Release%20Methodology%20Statement%20%28Approved%29%20v4.0%20-%20Effective%2031%20July%202017.pdf>

Rules for Release of Incremental Capacity at Interconnection Points –

<https://www.gasgovernance.co.uk/sites/default/files/ggf/page/2017-08/EID%20Section%20E%20-%20Rules%20for%20the%20Release%20of%20Incremental%20Capacity%20at%20Interconnection%20Points.pdf>

## 5 Solution

Insert the NPVs test from Entry Capacity Release Methodology Statement, Chapter 6 into UNC TPD Section B – System Use and Capacity.

The NPV tests then need to be amended to allow for;

- an “Incremental Capacity Premium” to be applied should the NPV test fail (i.e. revenues from the sale of incremental capacity will not achieve 50% of Estimated Project Value). For the avoidance of doubt, the Incremental Capacity Premium is an additional quantity that is added to the applicable payable price, calculated to be the minimum value required to allow the NPV test to be passed in the case where the allocation of all offered incremental capacity at the estimated reference price would not generate sufficient revenues for a positive NPV test outcome;
- A minimum requirement of 8 quarters of Incremental Capacity to be signalled over the 32 quarter period to guarantee there is a sustained incremental signal to ensure efficient investment in the system;
- Incremental Capacity profiles to be reassessed ahead of the second NPV test prior to capacity allocation (at the end of PARCA Phase 2). This includes the recalculation of the Incremental Capacity Premium, if applicable;
- The project value for the remaining duration of the PARCA application to be fixed at the time of the 1<sup>st</sup> NPV test (at the end of PARCA Phase 1).

## 6 Impacts & Other Considerations

### Does this modification impact a Significant Code Review (SCR) or other significant industry change projects, if so, how?

None. There is no impact on the current UNC Modification 0621 (and alternates) that is due for implementation in 2019.

### Consumer Impacts

If implemented this modification will reduce barriers to entry for investment in the GB network, having a positive impact on security of supply. There is no negative impacts to consumers as this modification alters the arrangements between Shippers and National Grid Gas only.

### **Cross Code Impacts**

None.

### **EU Code Impacts**

There is no impact on EU Codes The proposed modification is compliant with current EU Codes.

### **Central Systems Impacts**

It is not anticipated that this Modification has any Central System Impacts.

DRAFT

## 7 Relevant Objectives

Impact of the modification on the Relevant Objectives:

Relevant Objective	Identified impact
a) Efficient and economic operation of the pipe-line system.	Positive
b) Coordinated, efficient and economic operation of (i) the combined pipe-line system, and/ or (ii) the pipe-line system of one or more other relevant gas transporters.	None
c) Efficient discharge of the licensee's obligations.	None
d) Securing of effective competition: (i) between relevant shippers; (ii) between relevant suppliers; and/or (iii) between DN operators (who have entered into transportation arrangements with other relevant gas transporters) and relevant shippers.	Positive
e) Provision of reasonable economic incentives for relevant suppliers to secure that the domestic customer supply security standards... are satisfied as respects the availability of gas to their domestic customers.	None
f) Promotion of efficiency in the implementation and administration of the Code.	None
g) Compliance with the Regulation and any relevant legally binding decisions of the European Commission and/or the Agency for the Co-operation of Energy Regulators.	None

Demonstration of how the Relevant Objectives are furthered:

- a) Since the creation of the ECRM and the NPV the behaviour of those using the NTS has changed dramatically. The move from Long Term to Short Term Entry Capacity bookings has made the Release of Incremental Capacity difficult without purchasing an significant amount of unsold capacity. This is uneconomical and results in inefficient capacity bookings. This modification seeks to update the NPV tests and bring them up to date with the current developments and usage of the NTS.
- d) This modification allows the signalling of Incremental Capacity without the need to purchase all the currently unsold capacity at a System Entry Point, which; a) unfairly penalises a shipper intending to acquire incremental capacity; and b) will result in a shipper holding capacity which it has no intention of using (an unintended allocation of capacity). The allocation of capacity to a shipper via a strict interpretation of the current NPV test (which, as noted above, does not seem to be aligned with the intended purpose) is detrimental to competition by artificially limiting access to entry capacity for other shippers. The proposed modification also reduces the barriers to entry for investment into GB as it allows incremental capacity to be reserved where needed, without the need to purchase excessive amounts of unsold capacity.

## 8 Implementation

A decision is required by the Authority by the 26<sup>th</sup> October 2018 with implementation by the 31<sup>st</sup> October 2018 to ensure South Hook Gas is able to comply with the rules of the PARCA application, and also to ensure there is no impact on the upstream final investment decision timing.

No implementation costs are anticipated.

## 9 Legal Text

### Text Commentary

Insert text here

### Text

Insert text here

## 10 Recommendations

### Proposer's Recommendation to Panel

Panel is asked to:

- Agree that this modification should be treated as urgent and should proceed under a timetable approved by the Authority.