

Representation - Draft Modification Report UNC 0667

Inclusion and Amendment of Entry Incremental Capacity Release NPV test in UNC

Responses invited by: **5pm on 21 May 2019**

To: enquiries@gasgovernance.co.uk

Representative:	Adam Bates
Organisation:	South Hook Gas Company Ltd.
Date of Representation:	21 st May 2019
Support or oppose implementation?	Support
Alternate preference:	
Relevant Objective:	<p>a) Positive</p> <p>d) Positive</p>

The consultation is aimed at establishing if the content/effect of the variation have caused you to change a view that you previously expressed, or to take a view that you had not previously considered. Please note any representation received in respect of Modification 0xxx will be carried forward should parties not wish to change their original representation.

Reason for support/opposition: Please summarise (in one paragraph) the key reason(s)

As a current PARCA applicant we have identified issues with the NPV test associated with the release of funded incremental capacity (the “**NPV test**”) where the current methodology requires excessive amounts of capacity to be signalled due to the unconstrained nature of the NTS and low levels of long-term booking. This results in an uneconomic and inefficient methodology and potentially disincentivises investment into Great Britain. Considering these concerns South Hook Gas has proposed to move the NPV test into the UNC, as it currently sits in the Entry Capacity Release Methodology, and then amend the test to ensure it is fit for purpose going forward.

Amendment of the NPV test

This modification fixes an acknowledged issue that requires PARCA applicants to signal excessive quantities of capacity in order to pass the NPV test, far in excess of any required financial commitment. Ultimately, the changes proposed within the Modification solution further relevant objectives by:

- i) Making the NPV test consistent with the current market environment;
- ii) Minimising the requirement for shippers to book excess capacity, thereby minimising inefficient and uneconomic bookings;
- iii) Not artificially limiting access to entry capacity for other shippers; and
- iv) Reducing barriers to entry for gas market investment into GB.

Inclusion of the NPV test within UNC

The NPV test is currently defined within the Entry Capacity Release Methodology which is not subject to the UNC governance process and therefore restricts the ability of Users to propose amendments and cannot be modified without a full review of the methodology statements.

We feel the UNC is a more appropriate governance framework for the NPV test as it

- i) Allows for a more transparent and efficient process for any future amendments; and
- ii) Corrects the inconsistency between the NPV test (defined in the Entry Capacity Release Methodology) and the user commitment test associated with non-funded incremental capacity, which is currently defined within UNC¹.

Self-Governance Statement: *Please provide your views on the self-governance statement.*

This Modification should not be considered self-governance due to the material impacts to the user commitment test.

Implementation: *What lead-time do you wish to see prior to implementation and why?*

There has been discussion within the workgroup regarding whether this Modification would require a change to NGG's licence. We do not believe this is the case as this Modification would have no adverse impact upon National Grid's ability to discharge its relevant licence objectives². Moving the NPV test into UNC would only require a cross-reference to be added to the methodology statement which is consistent with the approach taken for other Modifications raised^{3,4}. It is worth noting that, as part of UNC Modification 452V, the user commitment test for substitution was included within the UNC⁵ and, as far as South Hook Gas are aware, a licence change was not required to reflect this change to the Entry Capacity Substitution Methodology.

¹ UNC TPD Section B 1.17.7(c)(ii)

² Namely, Special condition 9A and 9B

³ PARCA Process – ECRM Paragraph 93

⁴ Estimated Project Value – ECRM Paragraph 136

⁵ UNC TPD Section B 1.17.7(c)(ii)

This Modification should be implemented as soon as reasonably possible and should not be contingent on the implementation of any changes required to the Entry Capacity Release Methodology such as the cross-references noted above.

Impacts and Costs: *What analysis, development and ongoing costs would you face?*

If the changes prescribed within this Modification are not implemented, South Hook Gas believes the current methodology may unintentionally disincentivise investment in the NTS and could restrict future gas supply projects.

The implementation of this Modification has no consequential impacts on other users' charges as the alterations only ensure that the incremental revenue signal can be achieved as efficient as possible, based on the current usage of the NTS.

Legal Text: *Are you satisfied that the legal text will deliver the intent of the Solution?*

Yes

Are there any errors or omissions in this Modification Report that you think should be taken into account? *Include details of any impacts/costs to your organisation that are directly related to this.*

No

Please provide below any additional analysis or information to support your representation

In parallel to the development of this Modification, NGG has raised a review of its Entry Capacity Release Methodology. The key differences between the solution within this Modification and the Entry Capacity Release Methodology review are:

- i) NGG proposes to introduce a minimum booking duration requirement; and
- ii) South Hook Gas proposes to fix the Estimated Project Cost at the end of PARCA Phase 1 (subject to inflation).

Despite the Methodology review process sitting outside of this Modification, South Hook Gas feels it is important to set out our concerns in respect of points (i) and (ii) above to highlight why the Modification was initially raised and continues to be proposed.

Impacts of imposing a minimum duration on the funded incremental user commitment test

Introducing a minimum booking duration for the NPV test results in revenues being signalled in excess of those required to pass the test. This is highlighted within NGG's analysis at March 2019 Transmission Workgroup⁶. In all 3 scenarios in the analysis, the

⁶ Slide 12 - <https://gasgov-mst-files.s3.eu-west-1.amazonaws.com/s3fs-public/ggf/book/2019-03/8.0%20Capacity%20Methodologies%20Review%200667%20v2.0.pdf>

User passes the financial element of the NPV test and is then subject to additional costs, with 2 of the scenarios resulting in the User signalling double the required commitment.

Including a minimum duration results in a solution which is not cost reflective of the user commitment required and could result in inefficient and uneconomic booking of capacity. We are also concerned that it may be contradicting NGG's licence requirements to facilitate competition and non-discriminatory access to the network. For this reason, we do not think a minimum duration (in excess of the 4 quarters of incremental proposed) should be applied.

It is worth noting that, within the Entry Capacity Release Methodology, NGG made it clear that the minimum duration element has been proposed in order to avoid creating an incentive for applicants to pursue funded incremental capacity in preference to existing or substituted capacity. South Hook Gas has set out its views on this point in detail in its Entry Capacity Release Methodology review consultation response⁷. By way of summary, South Hook Gas does not believe that any such incentive would arise by virtue of the NPV test if amended consistent with this Modification ("**amended NPV test**"), but rather that it could result from the substitution user commitment test. The NGG analysis from March 2019 Transmission⁶ Workgroup clearly shows that, in all scenarios, the amended NPV test results in the user contributing the necessary amount required to pass the NPV test. This demonstrates that the amended NPV test would be cost reflective, economic and efficient. In contrast, the NGG analysis shows (as stated above) that the minimum duration aspect of the substitution/non-funded incremental capacity user commitment test results in scenarios where the user is contributing costs in excess of the estimated project costs of building any NTS reinforcements to release the capacity. This occurs despite substitution having zero, or minimal, costs associated with it. Therefore, we question whether the substitution/non-funded incremental capacity test is cost reflective, economic and efficient and do not consider it appropriate to apply this aspect to the funded-incremental NPV test as so doing would distort the NPV test and contradict NGG's licence obligations to release funded-incremental capacity in an economic and efficient manner.

Fixing of estimated project cost at PARCA Phase 1 completion

Both this Modification and the Entry Capacity Release Methodology review propose to continue with the LRMC methodology to calculate a "generic" estimated project cost. It is widely accepted that the LRMC methodology is volatile and unpredictable⁸ which is likely to result in the estimated project costs associated with any incremental capacity changing unpredictably year on year. Therefore it is unlikely that the required NTS investment will change in lockstep with the LRMC estimated project costs. Therefore, we believe it is appropriate to fix the project cost at the end of PARCA Phase 1 and index such costs in accordance with RPI to allow for greater certainty around any investment.

⁷ Paragraph 1.3 of South Hook Gas formal consultation response, can be found at <https://www.nationalgridgas.com/capacity/capacity-methodology-statements>

⁸ <https://gasgov-mst-files.s3.eu-west-1.amazonaws.com/s3fs-public/ggf/Conclusion%20of%20sensitivity%20analysis%20modelling%20v1.0.pdf>