

## Stage 04: Final Modification Report


# 0439:

## Notice for Enduring Annual Exit (Flat) Capacity Reduction Applications


At what stage is this document in the process?





The modification would remove the requirement for the 14 months' notice to apply for reductions in Enduring Annual NTS Exit (Flat) Capacity at July application windows, where the User Commitment has been, or will be, satisfied.

 Panel recommended implementation



 High Impact: -

 Medium Impact: Affected Users wishing to reduce exit capacity holdings

 Low Impact: Other Users

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## About this document:

This Final Modification Report will be presented to the Panel on 16 May 2013.

The Authority will consider the Panel's recommendation and decide whether or not this change should be made.


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# 1 Summary

## Is this a Self-Governance Modification?

The Modification Panel determined that this is not a self-governance modification.

## Why Change?

The 14-month lead time for reductions in holdings of Enduring Annual Exit (Flat) Capacity is restrictive and, on the face of it, arbitrary. The result is an inflexible capacity reduction process. Volatility in exit capacity charges can result in Users facing charges that may be an order of magnitude higher than when the User made its initial commitment to the additional capacity, thereby exposing it to unforeseen but significant increases in its operating cost.

Modification 0417S went part of the way to address these issues such that the resultant changes to the UNC mean that the 14 month notice period for a reduction request placed in year Y can be waived when the User Commitment Amount (UCA) both commences and is forecast to be fully met in gas year Y+1.

During the assessment of Modification 0417S it was noted that the proposed solution would only apply to capacity with a User Commitment attached to it. In this respect the solution precluded reductions of capacity with no User Commitment attached which might be viewed as being discriminatory and an unnecessary restriction.

## Solution

It is proposed to remove the “14 months’ notice rule” such that Users holding Enduring Annual NTS Exit (Flat) Capacity may apply, in the July application window of gas year Y, for a reduction with effect from the 1st of any month in gas year Y+1. Users with a UCA may apply for such a reduction only from the 1<sup>st</sup> of any month after the UCA has been forecast (based on published prices for year Y+1) to have been satisfied.

## Relevant Objectives

Removing restrictions on the ability to adjust exit capacity holdings will assist Users in signalling and holding their true capacity needs, thereby supporting efficient system development and avoiding sterilisation of capacity. Implementation would therefore facilitate achievement of relevant objectives c (Efficient discharge of the licensee's obligations), d (Securing of effective competition), and g (Compliance with European Regulation).

## Implementation

While no implementation timescale is proposed, it would be beneficial if this modification were implemented in advance of the next July application window, in order to allow Users who are exposed to the 14 month restriction to be allowed to submit a relevant reduction application.



## Definitions

### Enduring Annual NTS Exit (Flat) Capacity

(TPD B 3.1.5.c) is Annual NTS Exit (Flat) Capacity which may be applied for and registered as held (in a given amount) by a User with effect from the Day for which it is allocated, on the basis that the User will continue to hold such amount of capacity subject only to:

- (i) a reduction;
- (ii) the User ceasing to hold the capacity;
- (iii) any System Capacity Assignment.

### Reduction Application Window (TPD B 3.2.15)

A notice of reduction of Enduring Annual NTS Exit (Flat) Capacity may be given no earlier than 08:00 hours or later than 17:00 hours on a Business Day in the period 1 July to 15 July (inclusive) in any Gas Year (Y).

## 2 Why Change?

### Implementation of Modifications 0195AV and 0417S

In the notice of implementation for Modification 0195AV, the Authority noted that all of the 0116/0195 proposals (except 0116A) would introduce some form of user commitment under which Users that trigger new investment would be required to commit to pay the prevailing transmission charge at that offtake point for a period of four years. This principle is known as "User Commitment". The legal text for Modification 0195AV introduced the User Commitment through reference to the principles in the prevailing Exit Capacity Release Methodology Statement ("ExCR").

Under this principle, any User applying for, and being allocated, an increase to its Enduring Annual NTS Exit (Flat) Capacity, should remain the registered User of the allocated capacity plus any existing capacity that the User holds at the same NTS Exit Point until the earlier of:

- Four years after the date the increased capacity allocation becomes effective; or
- The date by which the User has paid, by way of NTS Exit Capacity charges, an amount equal to no less than the User Commitment Amount. Where the User Commitment Amount is four years NTS exit capacity charges based on the indicative (at the time of the application) NTS Exit Capacity charge for that NTS Exit Point (ie not the prevailing charge at the time of use).

Independent of the User Commitment, Modification 0195AV introduced a requirement that a User provides a minimum of 14 months' notice of a reduction in its Enduring Annual NTS Exit (Flat) Capacity holding, ie for a July Y reduction request, the earliest effective date would be 01 October Y+2<sup>1</sup>. Hence the User is committed to paying at least one year's prevailing charges.

Modification 0417S amended the minimum notice period requirement to address the issue where significant increases in NTS Exit Capacity charges result in the User satisfying its User Commitment within the first year after the increased capacity allocation becomes effective.

### Implications

Under the current arrangements for reducing Enduring Annual NTS Exit (Flat) Capacity ('enduring exit capacity') Users can be exposed to unexpected and significant increases in their NTS Exit Capacity charge. This can result in a significant increase in costs for those Users that are not covered by the circumstances of Modification 0417S (ie their User Commitment within the first year after the increased capacity allocation becomes effective).

The table below sets out some simplified examples of the different levels of potential financial exposure different Users face as a result of the current arrangements for reducing Enduring Annual NTS Exit (Flat) Capacity.

In this example User A has 1GWh of enduring exit capacity from the initialisation arrangements. User B applied for 1GWh of enduring exit capacity in 2009, and User C applied for 1GWh in 2010. Following a significant increase in exit capacity charges in April 2013 for the 2013-14 gas year, Users A and B face financial exposure through a significant increase in their exit capacity costs as a direct result of the 14 month requirement.

In the case of User B, this financial exposure is far greater than the indicative charges that formed the basis of the User Commitment Amount agreed when it applied for the enduring exit capacity.

Due to User C satisfying the circumstances of Modification 0417S (ie the UCA is forecast to be satisfied within the first year of its User Commitment), its financial exposure from the change in exit capacity charges is greatly reduced, and accords with its initial UCA.

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<sup>1</sup> Note: UNC allows, and the ExCR details, limited circumstances where a limit of 1<sup>st</sup> October Y+1 applies.

This means that those Users without a User Commitment and those with a User Commitment that is not satisfied in the first year, are potentially exposed to a significant financial risk if they do not meet the conditions provided for in Modification 0417S.

Date	User A	User B	User C
July 2009	Initialised with 1GWh capacity. No increase or reduction requests.	Application for 1GWh additional enduring exit capacity from Oct 2012 at indicative price (0.0001 p/kWh/d), resulting in a UCA of £1 per day for 4 years, ie £1461	
July 2010			Application for 1GWh additional enduring exit capacity from Oct 2013 at indicative price (0.0001 p/kWh/d), resulting in a UCA of £1 per day for 4 years, ie £1461
April 2012	National Grid sets actual price at 0.0001 p/kWh/d for 2012-13 (ie £1 per day) and publishes indicative charges for 2013-14 of 0.0001, p/kWh/d in 2013-14		
October 2012	The User commences paying the applicable exit capacity charge for the additional enduring exit capacity paying £1 per day.	The User commences paying the applicable exit capacity charge for the additional enduring exit capacity paying £1 per day	No capacity. No charges.
April 2013	National Grid sets the actual price for 2013-14 at 0.0021 p/kWh/d, resulting in a £21 per day charge. NB: If the April 2012 indicative charge for 2013-14 was higher, User A may have elected to reduce in July 2012 effective Oct 2013, ie before the significant price increase.		
	No User Commitment. User required to pay £21 per day	User determines that User Commitment satisfied in Nov 2013. (£1461-£366)/£21=53days	User determines that User Commitment satisfied in Nov 2013. £1461/£21=70days
July 2013	No User Commitment to satisfy so User applies for reduction 01 Oct 2013. Rejected: not 14 months' notice.	User applies for reduction as soon as User Commitment satisfied (01 Dec 2013). Rejected: not 14 months' notice.	User applies for reduction as soon as User Commitment satisfied (01 Jan 2013). Accepted: allowed by Mod 0417S.
July 2013	User applies for reduction with 14 months' notice (01 Oct 2014). Accepted.	User applies for reduction with 14 months' notice (01 Oct 2014). Accepted.	
October 2013	User commences paying higher NTS Exit Capacity charge		
December 2013			National Grid reduces the User's Enduring exit capacity, the User having paid an additional £441 more than their UCA.
October 2014	National Grid reduces the User's Enduring exit capacity, the User having paid <b>£7,665</b> at the higher rate.	National Grid reduces the User's Enduring exit capacity, the User having paid an additional <b>£6,552</b> more than their UCA.	

Further, there may be circumstances that exacerbate the financial risk of the 14 months' notice period for those Users subject to a UCA (and who do not meet the provisions of Modification 0417S). For example a one off change to exit capacity charges, as permitted under the UNC (and as is being considered for April 2013), could result in a User meeting its User Commitment in year Y, but as that change occurred during the year Y, the User would still be subject to the 14 months' notice, and not be able to reduce capacity until 01 October gas year Y+2. Given the above, Users should be able to reduce capacity within the 14 month window.

Two options have been considered to address the situation outlined above:

- a) UNC could be modified, along the lines of Modification 0417S, to extend the scope for reduction requests to be accepted with less than 14 months' notice. The circumstances of the extended scope could be to allow a reduction with less than 14 months' notice where the User Commitment is projected to be satisfied in the second year after the date the increased capacity allocation becomes effective. This would exacerbate any discrimination issues with respect to non-User Committed capacity holders.
- b) Remove the 14 months' notice period for all Users. **This option is being pursued in this modification.** It should be noted that a reduction request will only be accepted with an effective date in Year Y+1, ie with less than 14 months' notice, if the User Commitment has been, or on the basis of known charges, is projected to be, satisfied. In this regard, this modification has no impact on, and makes no changes to, the User Commitment. Satisfaction of the UCA will continue to be a requirement for any reduction request to be accepted (except where detailed in the ExCR).

### **Impact on National Grid Charges**

This modification should not affect National Grid NTS's allowed revenue. However, the modification is likely to result in some reduction in actual revenue received through NTS Exit Capacity charges. Other things being equal, this shortfall in actual revenue will be recovered through an increase in NTS Exit Commodity charges and/or an adjustment to capacity charges.

## 3 Solution

### Removing the 14 months notice rule

It is proposed to remove the "14 months notice rule" such that Users holding Enduring Annual NTS Exit (Flat) Capacity at an NTS Exit Point who do not (or on the basis of known charges will not) have an unsatisfied User Commitment at the NTS Exit Point (i.e. their UCA has been, or will be satisfied) are allowed to make an application during the Reduction Application Window in Gas Year Y for a reduction of their registered NTS Exit Capacity at that NTS Exit Point with effect from the 1<sup>st</sup> of any month:

- After the UCA has been (or will be) satisfied; and
- No earlier than 1<sup>st</sup> October Y+1.

National Grid NTS will not reject such an application unless National Grid NTS determines that:

1. the UCA will not be fulfilled before the requested date for the reduction to take effect; or
2. the requested date is not 1<sup>st</sup> of the month; or
3. the requested date is before 1st October Gas Year Y+1.

Consistent with existing provisions of UNC, where an application does not satisfy the criterion in bullet 1 above (but satisfies bullets 2 and 3) National Grid NTS may give effect to the reduction application (acting in its sole discretion) from the User Reduction Date specified in the User's application, where:

- (i) a User has applied to be registered as holding Enduring Annual NTS Exit (Flat) Capacity at any NTS Exit Point; and
- (ii) National Grid NTS is able to satisfy such application by reason of giving effect to the reduction applied for.

#### User Pays

Classification of the modification as User Pays, or not, and the justification for such classification.

National Grid has indicated that implementation should not require changes to central systems. It does not, therefore, fall within the definition of a User Pays Modification.

Identification of Users of the service, the proposed split of the recovery between Gas Transporters and Users for User Pays costs and the justification for such view.

Not applicable.

Proposed charge(s) for application of User Pays charges to Shippers.

Not applicable.

Proposed charge for inclusion in the Agency Charging Statement (ACS) – to be completed upon receipt of a cost estimate from Xoserve.

Not applicable.

## 4 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.	Positive
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.	Positive

The current UCA and notice period requirements expose Users to uncertainty regarding their potential financial exposure particularly when signalling a requirement for additional Enduring Annual NTS Exit (Flat) Capacity. This modification would allow those Users to better manage their capacity holdings and financial exposure.

Implementation would have three key benefits. First it would provide Users with greater certainty regarding their potential financial exposure when signalling for additional exit capacity. Second, it allows Users to provide a clear signal of how they intend to manage exit capacity at the relevant exit point. Third, it would allow Users greater scope to respond to prevailing price signals.

This would facilitate the Relevant Objectives as follows:

### **Achievement of relevant objective (a) "Efficient and economic operation of the pipe-line system"**

In its response, Gaslink argued that enabling users to reduce enduring capacity holdings that are no longer required (and for which the original user commitment amount has been satisfied) would allow National Grid NTS to make that capacity available for use by others, thereby promoting the efficient and economic operation of the pipeline system.



## **Achievement of relevant objective (c) "Efficient discharge of the licensee's obligations"**

In its response, Gaslink suggests that the modification would potentially improve capacity planning and thereby promote the efficient discharge of licence obligations relating to economic and efficient system development.

## **Achievement of relevant objective (d) "Securing of effective competition"**

Shippers and DN Operators (both as Users) would benefit from the implementation of this modification by avoiding the unnecessary holding of Enduring Annual NTS Exit (Flat) Capacity when it is not needed (or cannot be used). Such holding of capacity would cause the relevant User to incur additional costs (by way of NTS Exit (Flat) Capacity Charges) that could have a detrimental financial impact upon their business.

Allowing Users to hold capacity rights that more closely match their actual requirements would help to ensure that costs are allocated appropriately and so facilitate the securing of effective competition.

In addition, under the current arrangements not all Users, in all circumstances, are bound by the 14 months' notice period requirement. Hence, some Users have greater flexibility to manage their exit capacity holdings and corresponding costs than other Users.

This modification will ensure that all Users are subject to the same rules for reducing exit capacity holdings, and therefore should improve competition between Users and minimise discrimination.

Further, this modification would improve the exposure resulting from the UCA for Users, reducing risk and so benefiting competition.

## **Achievement of relevant objective (g) "Compliance with European Regulation"**

This modification would facilitate National Grid NTS' compliance with article 16(2) of EC Regulation 715/2009, which obliges the "transmission system operator [to] implement ...non-discriminatory and transparent capacity allocation mechanisms, which shall: (a) provide appropriate economic signals for the efficient and maximum use of technical capacity ...;"

This is because it would reduce the lag between when National Grid NTS provides the exit capacity charge signal and when Users' responses to that signal can take effect.

## 5 Implementation

While no implementation timescale is proposed, it would be beneficial if this modification were implemented in advance of the next July application window, in order to allow Users who are exposed to the above condition to be allowed to submit a relevant reduction application.

National Grid NTS has indicated that the recommended solution should not require system changes.

## 6 Legal Text

### Text

The following Text has been prepared by National Grid NTS. Whilst consultation respondents agreed that the legal text supports the intent of the modification, Scotia Gas Networks suggested that the text could have been clearer in specifying that the modification applies to exit points where there has never been any user commitment.

#### TPD Section B

*Amend paragraph 3.2.16 to read as follows:*

- 3.2.16 ~~Without prejudice to paragraph 3.2.17, t~~The earliest date upon which a reduction may be effective shall be 1 October in Gas Year Y+1 or such later date (being the first day of a calendar month) as determined in accordance with the principles in the prevailing Exit Capacity Release Methodology Statement.

*Amend paragraph 3.2.17 to read as follows:*

- 3.2.17 ~~Where a User has applied for a reduction of Enduring Annual NTS Exit (Flat) Capacity specifying a User Reduction Date which is earlier than 1 October in Gas Year Y+2,~~ National Grid NTS:
- (a) may give effect to the reduction (acting in its sole discretion) from the User Reduction Date specified in the User's application ~~where the User Reduction Date is not after the end of the commitment period as determined in accordance with the principles in the prevailing Exit Capacity Release Methodology Statement (“Commitment Period”)~~, where:
    - (i) a User has applied to be registered as holding Enduring Annual NTS Exit (Flat) Capacity at any NTS Exit Point; and
    - (ii) National Grid NTS is able to satisfy such application by reason of giving effect to the reduction applied for; or
  - (b) will give effect to the reduction from the User Reduction Date specified in the User's application; ~~where:~~ the User Reduction Date is after the end of the Commitment Period.
    - ~~(i) the User Reduction Date is after the end of the commitment period as determined in accordance with the principles in the prevailing Exit Capacity Release Methodology Statement (“Commitment Period”); and~~
    - ~~(ii) the Commitment Period commences in Gas Year Y+1; or~~
  - ~~(c) may give effect to the reduction from 1 October in Gas Year Y + 2 where the circumstances in paragraphs (a) and (b) do not apply.~~

## 7 Consultation Responses

Representations were received from the following parties:

<b>Company/Organisation Name</b>	<b>Support Implementation or not?</b>
British Gas Trading	Support
Centrica Storage	Support
EDF Trading	Support
Gaslink Independent System Operator	Support
Gazprom Marketing & Trading	Support
National Grid Distribution	Support
National Grid NTS	Support
Noble Europe	Support
Northern Gas Networks	Support
Scotia Gas Networks	Support
Total Gas & Power	Support

The eleven representations received unanimously supported implementation.

### Additional Issues Identified in Responses

National Grid NTS considers that the modification potentially increases the risk that indicative charges will be inconsistent with actual charges. The magnitude of any increase required between May (indicative) and August (actual) will depend on the extent to which Users reduce their registered capacity with less than the current 14 months notice. Whilst the extent of such reductions is impossible for National Grid NTS to accurately predict, a reduction in National Grid NTS' exit capacity revenue of 10% would require a corresponding increase to the TO exit commodity charge of approximately 0.0018p/kWh. This equates to 16% of the April 2013 TO exit commodity charge rate. Although this risk will apply each year, the magnitude is likely to be highest in the initial year or in future years where a significant increase in capacity charges occurs.

## 8 Panel Discussions

The Panel Chair summarised that this modification seeks to remove the “14 month” rule, such that holdings of Enduring Annual NTS Exit (Flat) Capacity can be reduced earlier than otherwise. This would allow reductions with effect from the 1<sup>st</sup> of any month after the User Commitment Amount (if any) has been (or will be) satisfied, but no earlier than 1<sup>st</sup> October Y+1. Implementation would therefore allow Users to better manage their capacity holdings and the consequential financial exposure.

Members recognised that implementation could be expected to deliver benefits by allowing Users greater scope to respond to prevailing price signals. By providing Users with greater certainty regarding their potential financial exposure when signalling for additional exit capacity, since they would be aware that reductions could be made if charges were to increase, risk would be reduced. Reducing market risk is consistent with facilitating the securing of effective competition. Members also noted that reductions after indicative charges have been issued could mean that those indicative charges would be less reliable as an indicator of actual charges, which would reduce certainty and so increase market risk. However, Members felt the benefits outweighed this risk.

Members also noted that implementation could allow Users to provide a clearer signal of their underlying exit capacity requirements in the event that they wish to reduce the amount held and subsequently used. Providing for capacity holdings to better match true requirements would be expected to lead to Users only paying for the capacity they wish to hold, and so better allocate costs between Users. Accurate cost allocations provide a fundamental underpinning for competitive markets, and hence implementation could be expected to facilitate the securing of effective competition. In addition, the provision of improved signals of true capacity requirements would be expected to lead to efficient and appropriate decisions regarding system investment, and hence could facilitate the efficient discharge of the licensee’s obligations with respect to economic and efficient system development.

Members then voted unanimously to recommend implementation of Modification 0439.

## 9 Recommendation

### Panel Recommendation

Having considered the Modification Report, the Panel recommends:

- that proposed Modification 0439 should be made.