

UNC Workgroup 0597 Minutes

Rules for the release of incremental capacity at Interconnection Points

Friday 02 December 2016

Consort House, 6 Homer Road, Solihull B91 3QQ

Attendees

Chris Shanley (Chair)	(CS)	Joint Office
Lorna Dupont (Secretary)	(LD)	Joint Office
Anna Shrigley*	(AS)	Eni Trading & Shipping
Colin Hamilton	(CH)	National Grid NTS
Graham Jack	(GJ)	Centrica
Helen Bennett	(HB)	National Grid NTS
James Thomson*	(JT)	Ofgem
Lesley Ramsey	(LR)	National Grid NTS
Lucy Manning	(LM)	Gazprom
Malcolm Montgomery	(MM)	National Grid NTS
Matthew Hatch	(MH)	National Grid NTS
Richard Fairholme*	(RF)	Uniper

* via teleconference

Copies of all papers are available at: <http://www.gasgovernance.co.uk/0597/021216>

The Workgroup Report is due to be presented at the UNC Modification Panel by 19 January 2017.

1.0 Introduction and Status Review

1.1. Approval of Minutes (15 November 2016)

The minutes of the previous meeting were approved.

2.0 Consideration of Amended Modification

2.1 An Alternative Approach to Auctions

MM provided an illustration of the high level steps in the CAM process. Auctions were not seen as a viable method for allocation, and so NTS has been focusing on an alternative. There was a similar Economic Test in use currently but this would need adjustment for CAM. The commercial framework for various phases was also displayed, outlining tasks/outputs, where the rules sat, and potential impacts on the Licence).

Alternative Allocation

An alternative allocation approach was outlined, whereby it could follow the PARCA 'phase 2' as closely as possible, using the PARCA contract and retaining all the PARCA principles. The reservation of capacity allows the TSO to go through the planning process before allocation. Responding to a question from JT, MM explained what happened under the PARCA process if a party did not sign the contract on time; the risk would be the User's but NTS may still consider progressing the project.

MM explained there were conditional binding commitments. There are three allowed conditions under CAM (alternative allocation only), which National Grid NTS will support and these were:

1. Commitments linking or excluding commitments at other IPs;

2. Commitments across a number of different yearly standard capacity products at an IP; and
3. Commitments conditional on the allocation of a specific or minimum amount of capacity.

The PARCA process naturally caters for (2) and (3), and an appropriate Economic Test (ET) would have to take account of (1). Noting that an ET might cover a number of parties, if a party dropped out elsewhere the ET would have to be re-run. For this to work, all the TSOs would have to run an ET and have the contracts signed at the same time. It was envisaged there would be two PARCA-like processes (NTS and Adjacent TSO), and it would be conditional on both of these being satisfactory before capacity was reserved. MH briefly explained the ET in more detail, and what would happen if the process were dislocated by events/circumstances.

MH gave a brief update on the position in relation to dialogues with the various Adjacent TSOs regarding this proposed alternative approach/methodology; the NRAs will also need to agree. National Grid NTS was not proposing auctions and this appeared to be supported by all the Adjacent TSOs in their incremental processes. MM explained that the CAM process supports auctions and alternative approaches that include a method of allocating capacity. National Grid NTS is clear that it is doing PARCA for IPs and all the Adjacent TSOs are considering the use of complementary allocation processes. MH confirmed that an auction process would not be included in this Modification 0597 and if such a process were required in the future then a separate modification would need to be raised. It was confirmed that there could not be an auction process on one side and an application process on the other. Adjacent TSOs are looking to align their timelines to match with the National Grid NTS process. MH will be visiting the Irish NRAs in January to discuss compliance/agreement, but had yet to discuss with the Dutch that the non-auction approach is definitely acceptable.

Interconnector agreements were discussed and MH believed there was no need to make any changes to these (however, he may revisit just to make sure).

A schematic was then presented displaying an overview of the alternative allocation approach, following the existing process.

Economic Test

Three main parameters and the calculation formula were outlined.

- The Present Value (PV) of estimated increase in Allowed Revenue (**AR**).
- The PV of binding commitments (**R**) calculated as the sum of *(two components here, different price applied depending on whether (a) or (b))*:
 - (a) amount of incremental capacity x (estimated reference price + mandatory minimum premium); or
 - (b) amount of unsold technical capacity x mandatory minimum premium. *(The mandatory minimum premium is referred to in Tariff Code; CH explained it was an additional charge to effect a satisfactory pass of the ET.)*
- The f-factor (**F**) - currently set at 50% or 0.5.

A table was presented showing how (R) was calculated, and MM explained how this was applied. User commitment is only applicable for enduring products; this is a discrete product, and so that is not relevant.

Completing the ET was then discussed. It was observed that the f-factor on an Adjacent TSO side could be different to that on the NTS side and that this needed to be clarified. The NRA will set the level of the f-factor and National Grid NTS is discussing with Ofgem when

that would be anticipated to happen.

GJ asked if it had to satisfy a minimum number of years; MM noted this for checking but was not proposing to include it in the modification. The ET will be adapted to fit.

Action 1201: PARCA Rules/NPV over a number of years - MM to clarify this.

Responding to a further question from GJ, MM indicated that prices would be the prevailing prices at the time. GJ observed that parties needed to understand what goes into this test. MM responded that the payable price will be the reference/prevaling price plus the premium - this is what a party will pay. GJ then asked, under this methodology when does it become clear what the reference price will be for each year?

Action 1202: PARCA Rules/Reference Prices - MM to clarify when and how reference prices will be set for each year.

Action 1203: MH to clarify what is the initial price to get over the NPV test (to trigger the investment).

The ET was under discussion with Ofgem, and it was anticipated that it would go into the Methodology Statement.

Interaction Rules

MM confirmed the existing initiation rule for PARCAs, whereby a PARCA may not be initiated during an ongoing QSEC or EAFLEC process between certain dates. There was no equivalent restrictive rule for the CAM process. No benefit is gained by a restriction - it is impossible to avoid overlap with existing annual processes, as the IP process is more than 12 months long. The requirements were being considered.

MM explained the binding and non-binding phases, and an interactions timeline for 2017 was displayed. The CAM Incremental Release process was described. The Project Proposal depends on the outcome of other processes and how demand is to be met; reworkings can be done to obtain the best solutions. The red arrow indicated the binding part of the process - ET, reservation of capacity, etc (i.e. the equivalent to Phase 2 of a PARCA). The contract is not struck until the ET has been passed.

The binding phase of CAM needs to avoid overlapping with other processes, and the initiation of a domestic PARCA might be delayed to avoid interaction with the binding phase of CAM. JT observed that at the end of a PARCA Phase 2 National Grid NTS issues a notice about how it is going to meet capacity; certain risks may exist but a pragmatic approach should be taken, and there will need to be a 'forward looking view'.

MM went on to describe three scenarios where there was potential interaction with annual processes. The impacts were outlined. In the second scenario, where the ET could not be completed before running into the start of another allocation process, and if the reservation window had already been opened then NTS was proposing to set aside capacity for the binding process that started first, i.e. CAM.

In the third scenario, where the reservation window shuts and another allocation process is currently running (avoidance cannot be guaranteed), then it is proposed that capacity be set aside for the binding process that started first, i.e. other non-CAM process. The ET must then be deferred until allocations for the other process (QSEC or EAFLEC, but not PARCAs) are completed (this could take up to four months). For PARCAs, capacity is not set aside for these in the same way as an auction; however, once it is reserved under PARCA Phase 2 then it cannot be touched, i.e. it is no longer available for any process, including CAM.

The three scenarios and their individual interactive timelines were displayed. Some practical rules would need to be included in the modification (and were discussed later in the meeting under section 2.2) and also in the Methodology Statement.

Withholding 10% of Incremental Capacity

One of the CAM requirements is that 10% of incremental capacity should be withheld for short-term auctions, and there appeared to be two potential ways to manage this. MM illustrated this through means of a comparison table. For the first option, 'add obligation', a planning risk may be created (over build), or an incentive risk (need to manage extra); there may also be a revenue driver issue. GJ observed there might be concerns from an applicant's point of view in that it may negate certain projects. For the second option, 'over ask', where Shippers are to ask for more than is required, then National Grid NTS would still have the obligation and seek a revenue driver for the higher amount. This may not work and requires further consideration; the implications for Shippers need to be understood, and the effect on meeting the ET.

GJ asked, did the applicant pay for all or does the community contribute - who will cover the cost? MM explained that the proportion of cost paid by the Shipper versus that paid by community differs under the two options but is set by the 'f-factor'. It was recognised that National Grid NTS and Ofgem needed to discuss this and work out a sensible position.

Standard Auction Mechanism

For completeness, MM gave an overview of the auction process (what it would like should it be used). The auctions tie a party into a two year process. Each TSO completes its own ET; the risk is run of not getting the required capacity (across multiple IPS).

It was questioned whether the TSO could end up setting aside more than 10%, and this was briefly discussed, with MM explaining how it would all be added up/accommodated.

Asked if PRISMA was going to develop any more functionality to accommodate these auctions, MM believed that it was looking at requirements; depending on whether it was a TSO or CAM requirement, different parties may then pick up any costs (unknown as yet whether any such costs would be socialised or specific). It was observed that PRISMA needs regulatory oversight and that more transparency is required. Discussions were ongoing.

Moving on to refer to competing capacities (existing and incremental), MM noted these were two different concepts each with its own complexity. The CAM did not explicitly envisage using competing auctions for allocating incremental capacity, however because incremental capacity is tied to existing capacity then it is unavoidable if using auctions.

There were a number of implications, and these were demonstrated through examples of pairs of linked auctions. PRISMA has not developed rules yet, but this was what it might look like (competing auctions, rounds, etc). The issues were outlined. As a minimum a party might need to bid in four auctions, because it will not know which offer level will be allocated; a party may need to participate in an auction even if it had no direct interest/involvement in a project.

MM reiterated that auctions merge two complex processes (competing auctions and incremental auctions) together and rules were still to be developed. It also re-introduces the 'planning consent' issue that the PARCA process was brought into address. Conditional commitments are not possible in auctions. There would be a fixed two year cycle when using auctions, and there would be high system costs to implement them. For these reasons a PARCA-like process was preferred to an auction process; it was an established process for GB users and it offered the flexibility required.

The Workgroup agreed with this view.

2.2 Amended Modification

A draft, revised modification was displayed onscreen and MM outlined the proposed amendments.

Solution - Business Rules

The Business Rules were reviewed and discussed; MM had identified one other change through rereading CAM (relating to a requirement to resolve an ad hoc demand assessment phase before the start of the regular biennial demand assessment), and would double check for any others.

“Reservation Window” was not currently a UNC Defined Term, and it was suggested that this be clarified in the modification and the legal text. It was also suggested that the meaning of the word “assign” might need further clarity and MM agreed to consider these suggestions.

GJ observed that the expectation of ‘returned fees’ (at paragraph 7.3) was different to that in the existing PARCA process (for the application, not the reservation); if the test is not passed a party is refunded. MM believed that a change to the Licence might be required to enable a cost smearing, and that this needed further discussion with Ofgem. It was queried if the Workgroup’s report should include an explanation of why this was different to the existing PARCA process; it was suggested that this might be considered at the next meeting.

MM highlighted that a new section 8 had been added ‘Impact on other processes’ to cover off the three interaction scenarios presented earlier. This would ensure that clear rules could be applied if one of the three scenarios were to occur in the future.

Implementation

The March date had been replaced by Entry into Force (EIF); MM indicated that he was going to reconsider the wording of this section.

3.0 Development of Workgroup Report

Deferred to the next meeting (13 December 2016).

4.0 Review of Actions Outstanding

1101: *Reference PARCA phase 1 comparison to CAM* - National Grid NTS (MM) to provide an example of how CAM proposals align to PARCA binding aspects and other annual NTS capacity processes such as substitution, etc.

Update: Addressed in the presentation. **Closed**

1102: National Grid NTS (MM) to provide an indication of what happens to unsold capacity and the associated ‘lock down’ aspects, as part of a CAM incremental capacity project.

Update: Addressed in the presentation. **Closed**

1103: *Reference Modification BR1.4* - National Grid NTS (MM) to consider whether this includes demand for bundled capacity.

Update: Demand assessment needs to go individually to the TSOs, but the Economic Test and final allocation takes care of any capacity bundling (TSOs assess the levels/bundle as appropriate if there is a match). **Closed**

1104: *Reference Modification BR1.11.4* - National Grid NTS (MH) to seek a legal view on inclusion/retention of this business rule going forwards.

Update: MM confirmed this had been removed from CAM as a report, and so will be removed from the modification. **Closed**

1105: *Reference Modification BR4.3.4* - National Grid NTS (MM) to provide clarification of the Economic Test parameters.

Update: Addressed in the presentation. **Closed**

5.0 Next Steps

MM to consider the suggestions made in discussions at 2.0 above, and provide a formally amended modification for publication (as version 2.0), and a draft of the legal text and associated written commentary for review at next meeting (13 December 2016) if possible, (or if not then for the following meeting on 20 December 2016), to enable the development/completion of the Workgroup Report.

At the next meeting it is anticipated that the Workgroup Report will be developed.

6.0 Diary Planning

Further details of planned meetings are available at: www.gasgovernance.co.uk/Diary

Time/Date	Venue	Workgroup Programme
10:30, Tuesday 13 December 2016	Energy UK Offices, Charles House, 5-11 Regent Street, London SW1Y 4LR	<ul style="list-style-type: none"> Review of amended modification Review of draft Legal Text and commentary (<i>if available in time</i>) Development of Workgroup Report
10:30, Tuesday 20 December 2016	Consort House 2-6 Homer Road, Solihull B91 3QQ	<p><i>To be confirmed</i></p> <ul style="list-style-type: none"> <i>Review of draft Legal Text and commentary</i> <i>Development/completion of Workgroup Report</i>
10:30, Tuesday 03 January 2017	Consort House 2-6 Homer Road, Solihull B91 3QQ	<i>To be confirmed</i>
10:30, Tuesday 13 January 2017	Consort House 2-6 Homer Road, Solihull B91 3QQ	<i>To be confirmed</i>

Action Table (as at 02 December 2016)

Action Ref	Meeting Date	Minute Ref	Action	Owner	Status Update
1101	15/11/16	1.1	<i>Reference PARCA phase 1 comparison to CAM - National Grid NTS (MM) to provide an example of how CAM proposals align to PARCA binding aspects and other annual NTS capacity processes such as substitution, etc.</i>	National Grid NTS (MM)	Closed
1102	15/11/16	1.1	To provide an indication of what happens to unsold capacity and the associated 'lock down' aspects, as part of a CAM incremental capacity project.	National Grid NTS (MM/MH)	Closed
1103	15/11/16	1.2	<i>Reference Modification BR1.4 - National Grid NTS (MM) to consider whether this includes demand for bundled capacity.</i>	National Grid NTS (MM)	Closed
1104	15/11/16	1.2	<i>Reference Modification BR1.11.4 - National Grid NTS (MH) to seek a legal view on inclusion / retention of this business rule going forwards.</i>	National Grid NTS (MH)	Closed
1105	15/11/16	1.2	<i>Reference Modification BR4.3.4 - National Grid NTS (MM) to provide clarification of the Economic Test parameters.</i>	National Grid NTS (MM)	Closed
1201	02/12/16	2.1	<i>PARCA Rules/NPV over a number of years - MM to clarify this.</i>	National Grid NTS (MM)	Pending
1202	02/12/16	2.1	<i>PARCA Rules/Reference Prices - MM to clarify when and how reference prices will be set for each year.</i>	National Grid NTS (MM)	Pending
1203	02/12/16	2.1	MH to clarify what is the initial price to get over the NPV test (to trigger the investment).	National Grid NTS (MM)	Pending