Long Term Non-Firm Capacity
Business Principles

Option B: Non-Obligated Firm Capacity with buyback options attached

Summary

- This option utilises the Non-Obligated Firm Entry/Exit Capacity[1] product to provide capacity rights to the NTS prior to Incremental Firm Entry/Exit Capacity[2] availability.

- These business principles assume that this product will only be made available where an Incremental Firm Entry/Exit Capacity signal has previously been provided in respect of a new or existing entry or exit point (through, for example, a bilateral contract) and where the customer requests earlier access to the NTS i.e. in advance of Incremental Firm Entry/Exit Capacity delivery.

  Question: Should access to the product be limited to the user who has provided the incremental capacity signal or should it be limited only to the location where the signal has been received but available to all users?

- These business principles propose long term non firm capacity is released annually with monthly tranches using ad-hoc auctions/application windows. The capacity release type envisaged under this option is Non-Obligated Firm Entry/Exit Capacity.

- The quantity of long term non-firm capacity released would be sufficient to cover the customer's capacity requirement (taking into account an obligation to utilise any firm capacity that may become available prior to each annual release) for the period up to the expected Incremental Firm Entry/Exit Capacity delivery date (the 'early capacity period'),

- An annual capacity release mechanism is proposed, since it allows greater flexibility, fits with annual capacity price setting and provides customer certainty on the basis that the capacity would be made available every year up to the Incremental Firm Entry/Exit Capacity delivery date.

- Any long term non-firm capacity released would include an associated buyback option for all days on which the long term non-firm capacity is held, with an indication of the likelihood of buyback provided to the relevant user, based on risk analysis.

- The capacity price is suggested as 'pay as bid', to allow the customer to value the capacity, although this may require system changes. The buyback price is suggested as a zero option price with an exercise price at, or capped at, the price paid for the capacity. National Grid NTS (NG NTS) believe this pricing structure to be workable because it allows the customer to value the capacity but recover their costs on days where buyback is exercised.

---

[1] **'Non-Obligated Firm Entry/Exit Capacity'** means Firm NTS Entry / Exit Capacity over and above NTS Baseline Entry / Exit Capacity that National Grid NTS may choose to release entirely at its own discretion. Non-obligated Capacity does not set an enduring release obligation.

[2] **'Incremental Firm Entry/Exit Capacity'** means Firm NTS Entry / Exit Capacity released over and above existing obligated Entry / Exit Capacity levels that increases this obligation on an enduring basis.

For reference and in the context of these business principles, **'NTS Baseline Entry / Exit Capacity'** means the amount of Firm NTS Entry / Exit Capacity that National Grid NTS is obliged to make available to Users in accordance with National Grid NTS' Transporter licence (including the substitution of capacity from one ASEP to another ASEP).

- Draft business principles for the release of long term non-firm capacity under both the entry and exit capacity regimes are outlined below. Note that these are high level principles for discussion, and not intended to define process timings at this stage.

Business Principles

Initial notification of capacity requirements (process trigger)

1. The customer signals their requirement for Incremental Firm Entry/Exit Capacity in respect of a new or existing NTS Entry or Exit Point (through, for example, a bilateral contract).

2. NG NTS analyse and determine how the incremental quantity should be satisfied (e.g. via firm unsold, substitution, etc). If an NTS build decision is made, NG NTS would then ascertain whether the customer requires access to the NTS earlier than the expected Incremental Firm Entry/Exit Capacity delivery date (i.e. the 'early capacity period')..

3. If the customer requires access to the NTS during the early capacity period, long term non-firm capacity would then be released (as outlined in the release mechanism section later).

Capacity type

4. The capacity released as long term non-firm would be Non-Obligated Firm Capacity, each with monthly sub-transaction periods.

Capacity duration

5. Long term non-firm capacity would cover some or all of the early capacity period up to the estimated Incremental Firm Entry/Exit Capacity delivery date, subject to demonstration date principles being satisfied for the project, where a bilateral agreement is in place. Additionally, this rule should probably be incorporated into that agreement.

Capacity Release Frequency

6. A staged release mechanism would seem appropriate, releasing up to 12 months worth of long term non-firm capacity (and associated buy back options), year ahead, in each release.

7. A staged release mechanism has a number of benefits:

   - Capacity release can be flexible; allows the customer to tailor the capacity to their requirements and to correspond with any changes made to the estimated date of Incremental Firm Entry/Exit Capacity delivery as that date approaches.

   - The customer would be able to manage their credit exposure more flexibly, as they could review their financial position on an annual basis rather than being committed for a set number of years from the start. Current UNC credit rules would apply.

   - Fits with the current charging methodology, which is carried out annually.

   - Greater customer certainty is provided; in that long term non-firm capacity is guaranteed to be made available every year during the early capacity period - the actual release mechanism would only be an annual process for the above reasons.

8. At entry, each annual release would need to be held between May/June and September, to ensure all unsold firm capacity had been utilised, where available. At exit, the annual

releases would need to be held after the July Application Window, to ensure all unsold firm capacity had been utilised, where available.

Capacity release mechanism

9. An ad-hoc entry auction or ad-hoc application window (exit) would be held for the release and allocation of long term non-firm capacity.

10. An annual auction/application window frequency would seem appropriate for the release of the long term non firm product, given that the existing long term auctions and application windows are held annually.

11. The capacity allocation results of the existing long term auctions/application windows would need to be taken into account when determining the quantity of long term non firm capacity to be released.

12. Prior to each annual long term non firm capacity release via auction/application window, the customer would be expected to purchase any firm NTS Baseline Entry/Exit Capacity that had become available for the next Gas Year that could satisfy all or part of the customer's capacity requirement. Should there be a bilateral agreement in place, it may be appropriate that this rule is included within the terms of that agreement.

13. Any remaining capacity requirement would be met through the release of that quantity of long term non-firm capacity.

    Question: Would any information need to be published following long term non-firm capacity allocations, considering customer confidentiality?

Release criteria

14. A quantity of long term non-firm capacity up to the Incremental quantity signalled would be made available depending on the quantity required by the customer and whether any of that quantity could be met using unsold firm capacity.

15. Where a bilateral contract is in place between the customer and National Grid NTS, demonstration principles must be satisfied by the dates agreed within the contract. If the demonstration date has not been met then long term non firm capacity would not be released on the next scheduled release date, or thereafter.

Additional criteria

16. The relevant ASEP/NTS Exit Point must already be established and set up in the Licence

17. Current UNC credit provisions will apply.

18. System changes and impacts need to be understood.

Buyback Option setup

19. A buyback option agreement would be agreed at the same time as the allocation of long term non-firm capacity through the annual release mechanism.

20. The buyback option agreement would either be a Constraint Management Agreement (CMA) at entry or an Exit Constraint Management Agreement (ECMA), as appropriate.

21. The CMA or ECMA would be set to cover the quantity on all days for which long term non-firm capacity was allocated over the year ahead, with an indication of the likelihood of buyback provided to the relevant User, based on risk analysis. Where a bilateral contract is in place, the risk analysis could be included within the terms of this contract.

22. Indication of the likelihood of buyback would be provided to the relevant user for the capacity release period ahead at each annual release, although the granularity and appropriate level of detail in such a report would need to be considered.

Long term non-firm capacity pricing

Capacity

23. Pay as Bid pricing would seem most appropriate, as it allows the customer to 'value' the capacity. This should work at entry, but may not be compatible at exit, as a change to the existing regime of administered prices may require system changes. Consequently, it may be necessary to have different pricing rules at entry and exit to reflect these differences

24. At entry, the prevailing entry capacity reserve price could be used as the minimum capacity price, and the customer could choose to pay more, reducing the likelihood of buyback on constraint days i.e. a higher capacity price would mean a higher buyback price if the two are linked (see proposed Buyback Pricing mechanism below) and therefore less likelihood of buyback under the price order rules.

25. At exit, the price could be linked to the indicative or actual exit capacity price for obligated capacity corresponding to each period for which long term non-firm capacity is required.

    Question: Given that actual exit prices are only published in May (6 months before the gas year ahead) the adhoc application window for long term non-firm capacity would need to be after May, but also ideally after the July Application Window. The latter would ensure that all opportunities to buy unsold to meet the capacity requirement could be exhausted before long term non-firm capacity is released. However, this is very restrictive time-wise, so perhaps better to use the indicative price and hold long term non-firm applications between October and May?

Buyback

A zero option price is suggested, with the exercise price set to mirror the price paid for the capacity for that day. NG NTS have suggested this pricing mechanism because:

a) it allows the user to recover the cost of capacity charges on days where buyback is exercised; and

b) it maintains cost neutrality at entry under existing obligated incentive mechanisms (although not at exit due to differences in incentive sharing factors between costs and revenues at exit)

c) use of existing incentive mechanisms avoids the need for additional buyback allowances/revenue drivers, providing that both revenues and costs feed into the same incentive