

Pricing Volatility



NTS CMF – 6th September 2012

Agenda

- Review of last NTSCMF
 - Impacts of setting TO Exit Capacity charges in April
- ‘One-off’ change to charges in April
 - Comparison to permanent April annual charge setting
 - Potential timescales

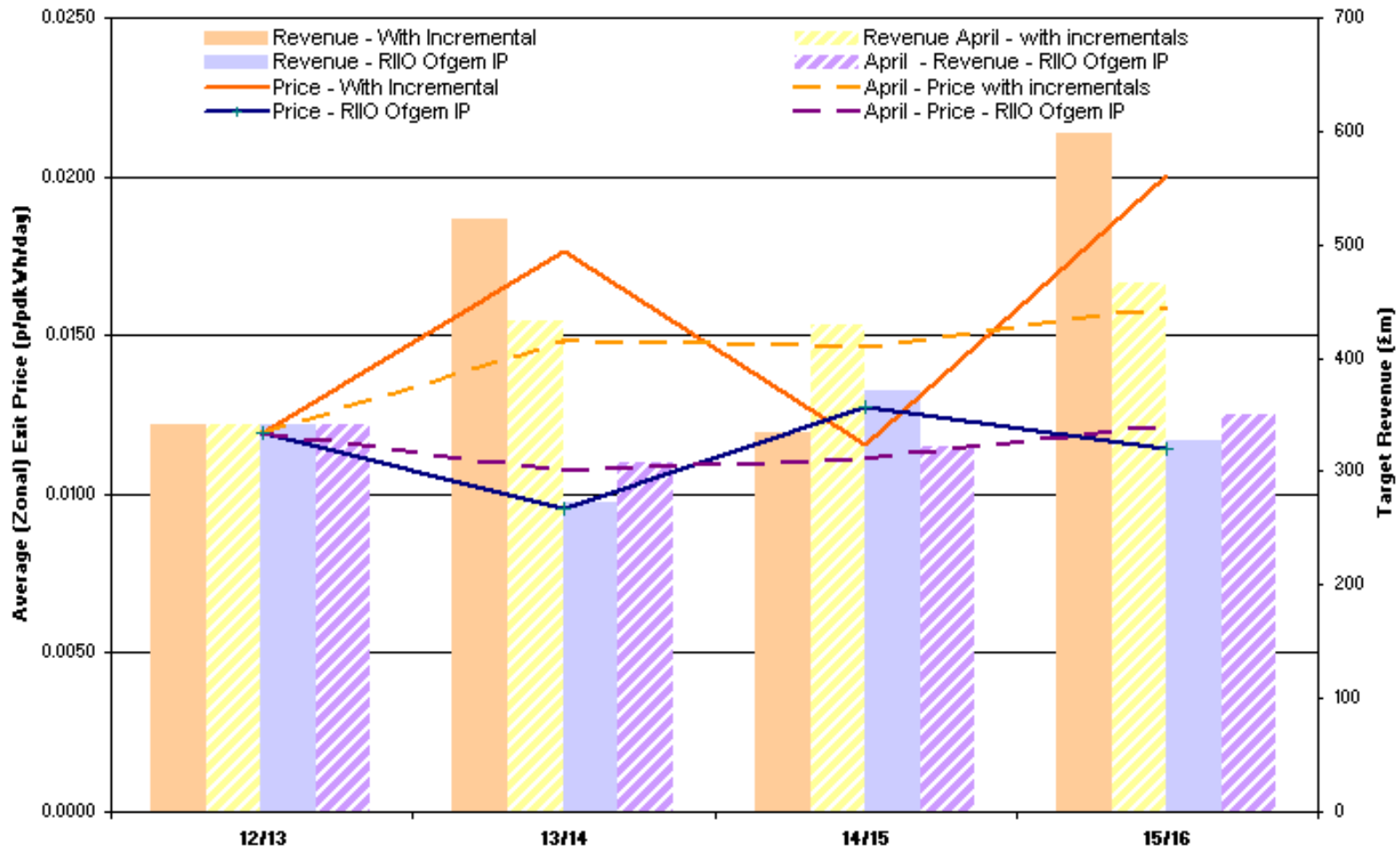
- Next steps

Review of last NTS CMF

In the last NTS CMF we looked at:

- The causes of volatility in TO Exit Capacity Charges- predominantly driven by
 - Allowed Revenue changes; and
 - Setting charges from October with Allowed Revenues applicable from April
- We profiled:
 - The impact on charges considering incremental capacity and RIIO-T1 March submission and Ofgem Initial Proposals; and
 - The impact on charges of a move to April charge setting for TO Exit Capacity Charges

RIIO-T1 Initial Proposals Impacts on Charge Changes – with April Change



Potential Options for changing charge setting

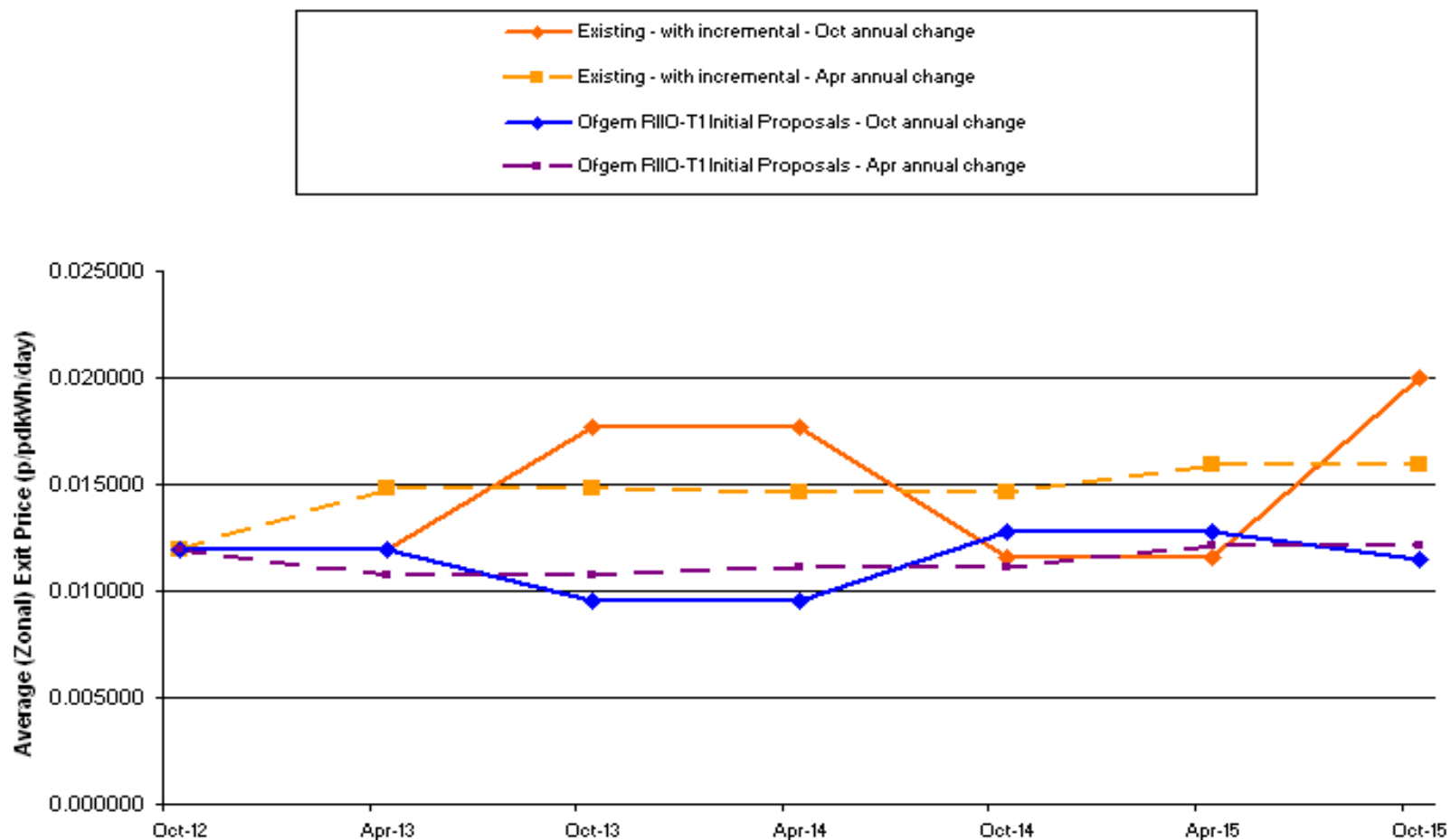
- What options are there?
- Based on discussions and feedback we have three potential options that we would like to discuss with regards to an April change
 1. Move to permanent April annual charge setting
 2. Incorporate a one-off April change
 3. Retain current process
 - Annual TO Exit Capacity Charges set from 1 October for one year (continued alignment with 'Gas Year')

Potential Option 1: Permanent April Annual charge setting

- A permanent move to April charge setting* :
- would help to stabilise prices
 - Should reduce the inherent volatility caused by a step change in Allowed Revenue from April 2013
- BUT
- A permanent move to April charge setting
 - Would require a UNC modification
 - Not enough time to complete process for April 2013

*Impact of allowed revenue only (i.e. not considering supply/demand changes and other factors)

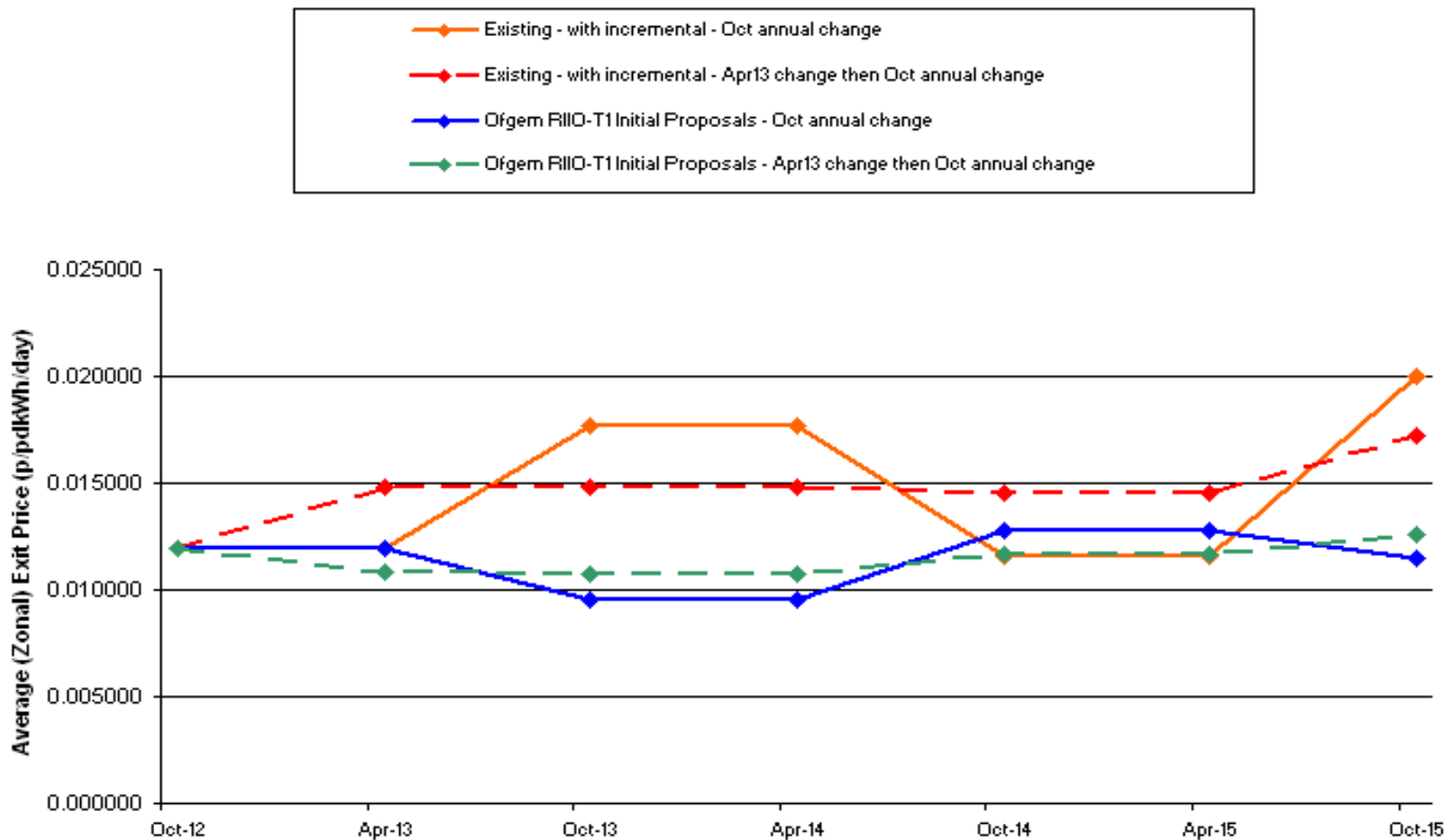
Impact on TO Exit Capacity Prices of permanent April charge setting



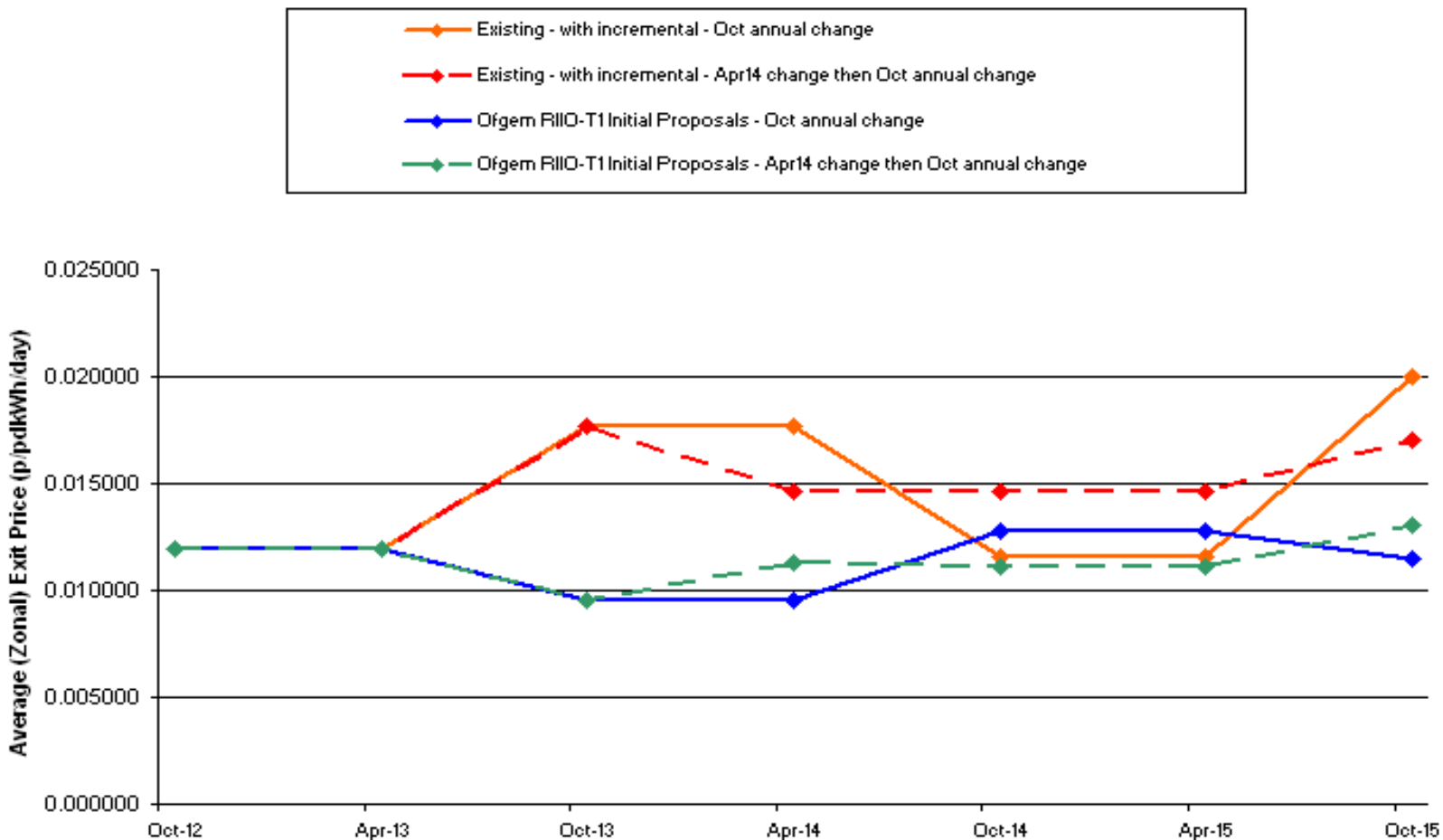
Potential Option 2: April 2013 One-off change

- A 'one-off' change in TO Exit Capacity charges with effect from 1 April 2013 for 6 months in response to RIIO-T1 values
 - Rather than for April 2013 this could be for April 2014
- Continue with annual TO Exit Capacity Charges set from 1 October 2013 for one year (continued alignment with 'Gas Year')
- Using March RIIO-T1 submission and Ofgem RIIO-T1 initial proposals, the impacts of incorporating an April one off change in 2013 or 2014 are shown on the following slides

Impact on TO Exit Capacity Prices of April 2013 one-off change



Impact on TO Exit Capacity Prices of April 2014 one-off change



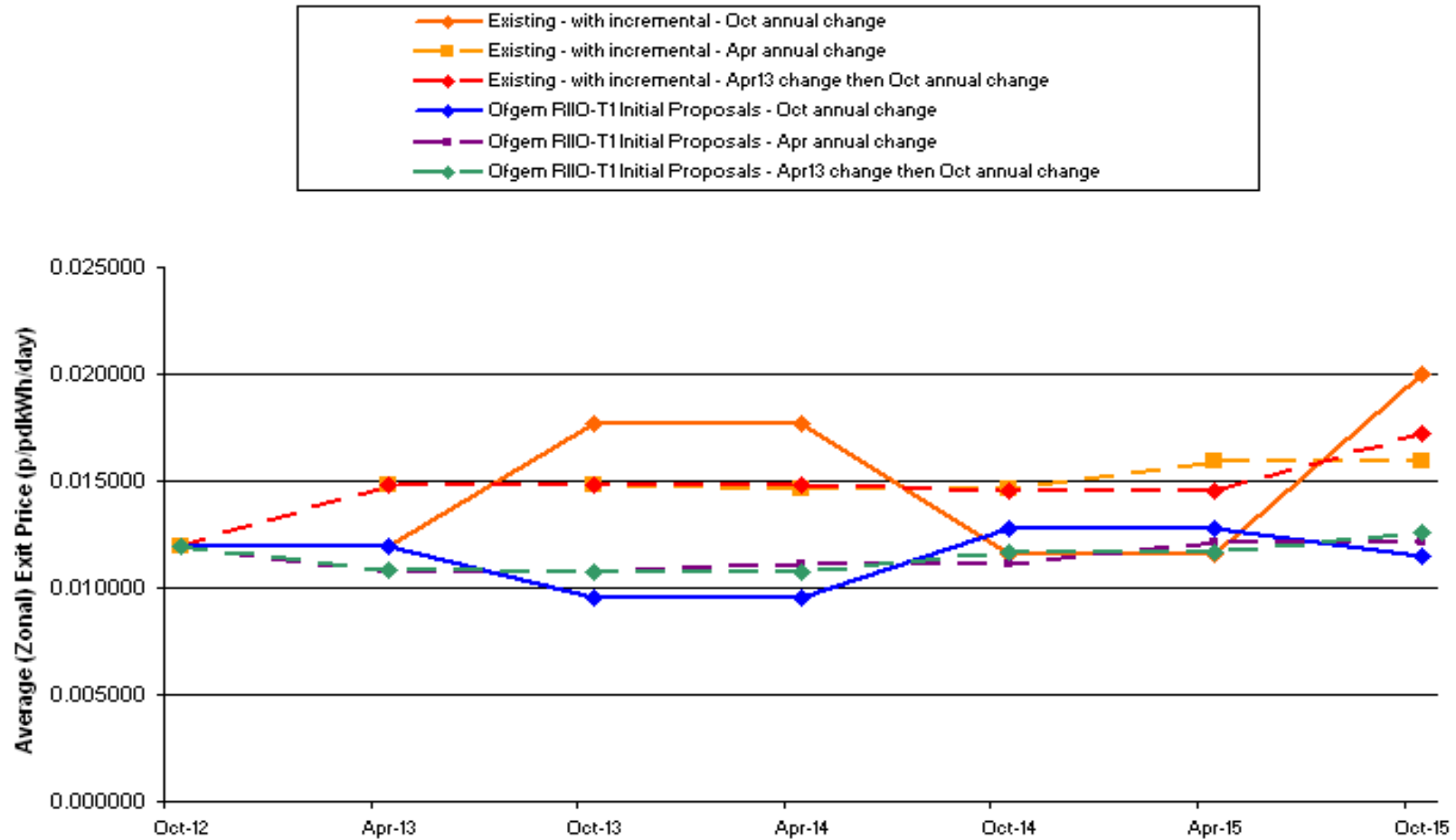
Potential Option 3: No change

- Retain current process
 - Annual TO Exit Capacity Charges set from 1 October for one year (continued alignment with 'Gas Year')
 - Volatility caused by allowed revenues would remain if there is a step change in allowed revenues (subject to outcome of RIIO-T1)

One-off April change vs. permanent April charge setting

- Principle behind either approach is the same
 - To achieve long term stability in prices at the earliest opportunity
- A one-off change acts as a stabiliser
 - That removes large swings in charges each time prices are updated to ensure allowed revenue is recovered
- A move to permanent April charge setting could further reduce volatility but there is only a marginal improvement on a one-off change

One-off April change vs. permanent April charge setting



One-off April change vs. permanent April charge setting

- Should there be a significant step change in TO Allowed Revenue we could keep option open for a future April change
 - If incremental revenue has an impact in later years of RIIO-T1 (dependant on revenues that come out in December)
 - Consider appropriate notice period, should be able to anticipate given indication of revenues under RIIO-T1 final proposals
 - Other causes of volatility remain (won't eradicate volatility) but the impact is significantly less than the Revenues impact
 - Change would only be made for the calculation of TO Exit Capacity Prices

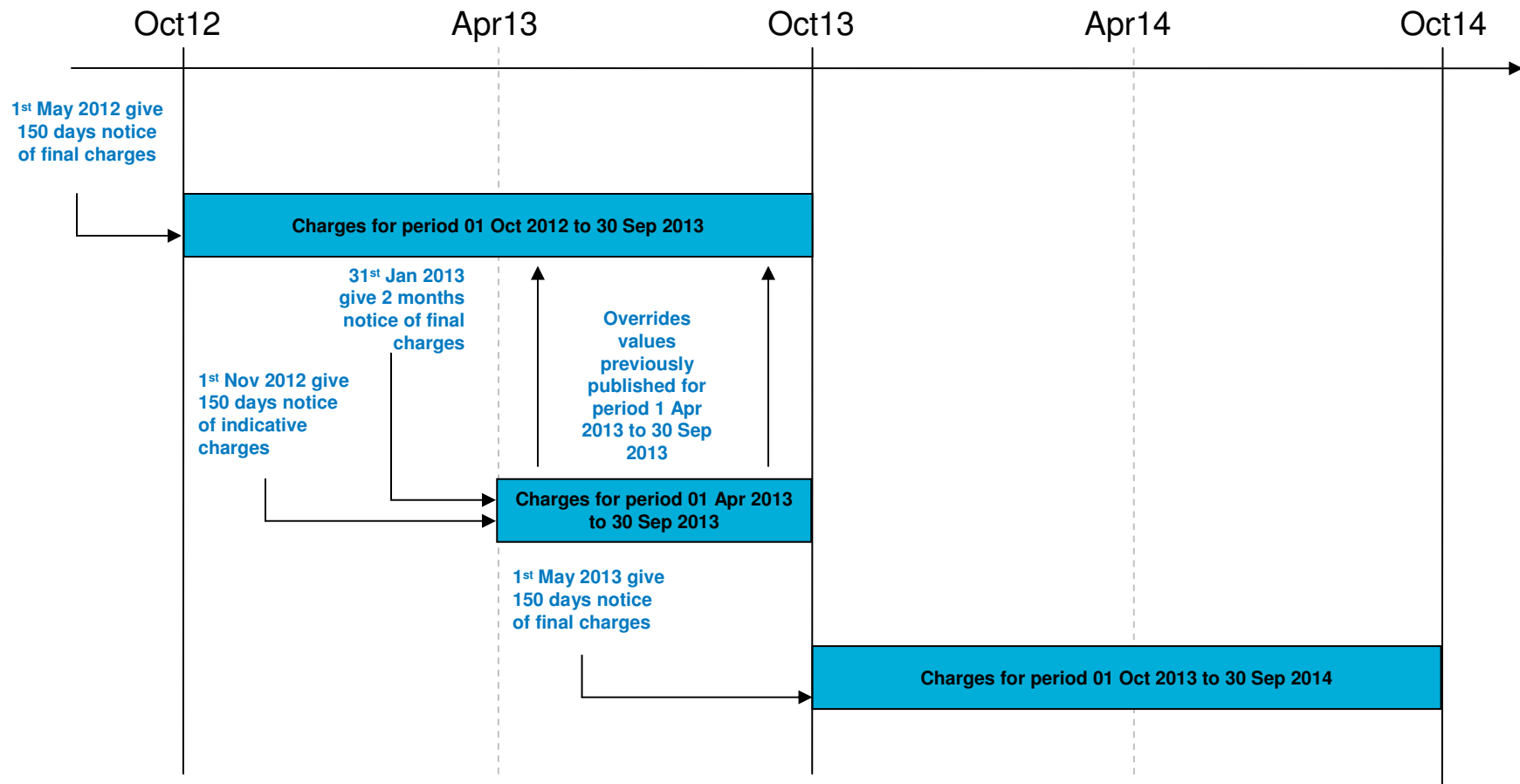
Responses to Ofgem's Pricing Volatility Consultation

- Q3.19 - “Do you agree that if changes are needed in the gas distribution and transmission sectors that they should be implemented on 1 April 2013, the start of the next price control period?”
- The majority of respondents supported this date for implementing any change so that it could be in place as soon as possible.
 - Some respondents did point out that gas transportation charges have been published effective from October 2012, and an April 2013 change may not be desirable
 - One suggested April 2014 as a more desirable date
- Regarding Notice periods for changes
 - Most respondents wanted as much notice as possible for network charge changes

Potential timeline for a one-off April change

- Subject to Stakeholders / Ofgem support for a one-off April change we would consult with industry
 - Issue discussion document
 - Indicative notice of potential for change in November
 - Would be dependent RIIO-T1 allowed revenues
 - If close to current levels no benefit in April 13 change.
- Hold an NTS CMF in December after RIIO-T1 Final Proposals to show impact on prices
- By 31 January 2013, provide final charges for 1 April 2013 – 30 September 2013

Possible change timeline



Next Steps (1/2)

- Is there appetite to review in time for April 2013?
- Open letter to gauge industry preferences on the three options & provide a chance for the industry to formally respond to the proposal
- Output of Ofgem volatility consultation needs to be considered
- Options are;
 1. Permanent move to April charge setting
 2. One-off April 2013 charge change
 - UNC modification consultation not required for a one-off April change.
 - Would need direction from Ofgem, if industry opinion supported such a change
 3. Keep current approach of setting charges in October
- Any other views / options?

Next Steps (2/2)

- Alternatively, maintain same arrangements
- Volatility will depend on the Final Proposals for RIIO-T1 and variance from 2012/13 allowed revenue
- If significant could review ahead of October 2013 / April 2014
- Would keep volatility over 2013/14 but could address in 2014/15 with more notice