

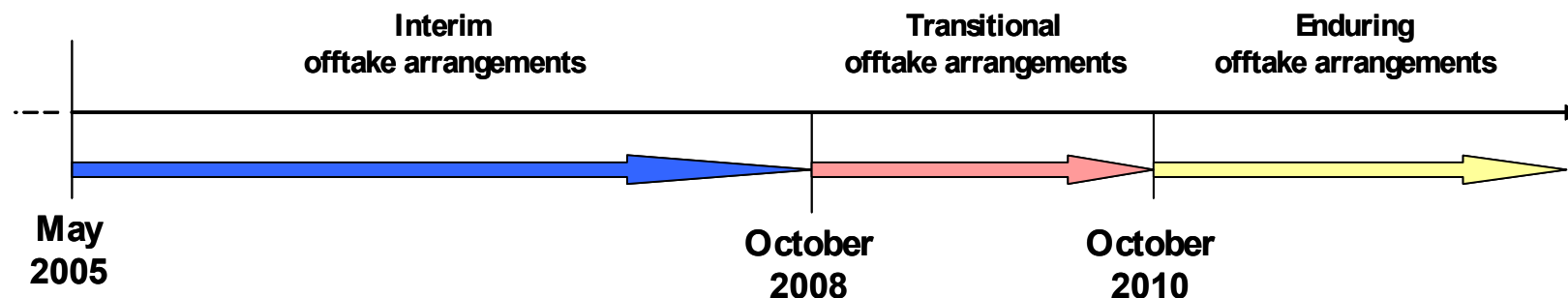
Overview of TPCR Initial Proposals – Offtake arrangements

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Transmission Workstream
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- Overview
- Enduring arrangements
 - Draft Impact Assessment
 - Strawman of arrangements
 - Revenue drivers and baselines
 - Incentives
- Transitional arrangements
 - Revenue drivers and baselines
 - Incentives
- Way forward

Overview

- TPCR Initial Proposals published 26 June 2006
- Outlines initial proposals on:
 - transitional regime; and
 - enduring regime.
- Overview in Chapter 11 & detail in Appendix 16.
- Draft IA in Appendix 17



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Initial proposals - Enduring offtake arrangements

- Continued emphasis on user commitment and improved investment signals.
- Equal opportunities for all classes of users to gain access to network over short and long term.
- Signals made by users backed by an appropriate level of financial commitment
- Initial proposals consistent with 3rd consultation
- More detail on nodal baselines, nodal revenue drivers, and substitution obligations.
- Plus draft impact assessment.

Product definition

- Third TPCR Consultation stated preference for “expanding flexibility” product and for combined product
- NGG NTS completed modelling in May – uncertainties associated with future flex availability under expanded flex approach
- NGG NTS decide not to proceed with expanded flex product.
- 2 products now proposed – flat and flex
- Ofgem and industry concern re diversity and risk of over investment
- NTS considering mechanisms to remove risk of over investment – eg flex zones.
- Discussions on product definition continue at EOWG
- Baseline numbers need to be specified for September document

User commitment / baselines

Baselines

- Pending work on product definition – no enduring baseline numbers provided in initial proposals
- Policy remains same - baselines specified by node (practical max phys), act as revenue driver “trigger” and define NGG NTS’ obligation to release capacity
- Baseline numbers to be consistent with transitional period baselines with adjustments to reflect product definition
- Baselines for five SW interruptible sites adjusted upwards (with additional revenue allowance for efficient contracting costs)
- More detail on substitution obligation – substitution methodology to be developed subject to Ofgem approval
- Any reallocation of baselines following long term allocation is subject to Ofgem approval

User commitment and 1 in 20 obligation

- Still consider that compliance with NGG NTS’s 1 in 20 obligation could be achieved by investing in line with user commitments signalling peak aggregate demand

Revenue drivers

- Revenue drivers contingent upon user commitment and applying to all load related capex
- Accrue on contractual (rather than physical) delivery of capacity
- Drivers apply for 5 years from contractual delivery date
- Propose to:
 - specify zonal revenue drivers for small capacity increments
 - specify project specific revenue drivers in relation to large, anticipated projects
 - modify the licence in relation to large unanticipated projects or new exit points
- 80% factor applied to Pembroke and Grain power stations (taking into account possibility of contracting solutions)

Incentives

Buy backs

- Investment related buybacks treated as excluded revenue subject to administered cap on buyback price (defaulting to zero after five years)
- 3 year investment lead time but NTS may apply to extend
- IAE arrangements will also exist
- Existing UNC arrangements for maintenance and unplanned outages apply with no proposals to change these – therefore no operational buy back incentive proposed.

Other issues

- Revenue from sale of non-obligated capacity subject to a sliding scale incentive, with 50% sharing factor and cap
- Obligation continues up to and including the gas day
- Interruptible on UIOLI and discretionary basis
- Principles for discretionary release to be defined.
- Movement to Option 2A payment flows model proposed in enduring offtake implementation timescales

Draft Impact Assessment (1)

- Appendix 17 includes a Draft IA of the proposals outlined in the Third TPCR Consultation
- Initial, conservative assessment of net benefits to customers: £20m-£67m (in PV terms)
- Conservative estimate because:
 - Cost estimates often “worst case” in nature
 - Variety of methods considered to extrapolate cost submissions and most conservative approach used to inform “low case” net benefits
 - Only three main benefit categories quantified (other benefits assessed on a qualitative basis)
- This is only a draft IA. We plan to perform at least one further impact assessment, informed by more detailed drafting by NGG NTS of potential business rules or UNC text

Draft Impact Assessment (2)

Benefits:

- Three quantitative benefits identified:
 - Efficient NTS investment signals
 - Non-discriminatory allocation of capacity products between RDNs and IDNs
 - Reduced incidence of ARCAs
- Qualitative benefits:
 - Efficient network development and system operation
 - Preventing undue discrimination (firm v interruptible / GDNs v TCCs)
 - Promotion of competition
 - Appropriate allocation of risk
 - Simplicity and transparency

Draft Impact Assessment (3)

Costs:

- In April 2006, Ofgem issued separate cost pro formas to:
 - Shippers and TCCs
 - Gas transporters and agency
- All respondents asked to provide upfront implementation costs and ongoing annual costs
- Assumptions document and guidance document attached
- Fourteen submissions received
- Full cost submissions and adjusted costs (removal of outliers) included in cost analysis
- Three different methods of extrapolation adopted
- Costs to both GTs and industry participants/customers in other jurisdictions considered but not included in calculation

Draft Impact Assessment (4)

Summary of cost and benefits cases

£ million (2006 prices) – 6% discount rate	High case	Base case	Low case
Benefits estimates	84.8	68.5	54.6
Costs estimates	35.1	22.5	18.3

Total PV of net benefits to customers

£ million (2006 prices)	High case	Base case	Low case
Net benefits to customers - 6% d.r.	66.5	45.9	19.5
Net benefits to customers – 3.5% d.r	88.8	61.8	26.8

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Transitional revenue drivers and baselines

Baselines



- Propose that baselines in transitional period will be used only as “trigger” point for incremental investment revenue
- Based on practical maximum physical capability of network
- No baselines proposed for interruptible capacity
- No baselines for flexibility proposed for this period

Revenue drivers



- Propose incremental revenue triggered on contractual delivery, rather than physical delivery
- Consistent with enduring proposals, as far as possible
- Given a partial user commitment model some revenue may be triggered absent a user commitment

Transitional incentives

- Propose removing charges foregone / exit investment incentive
- Propose retaining CLNG incentive (including in enduring period)
- Propose to exclude all buy-backs from buy back / >15 days incentive
- Propose retaining > 15 day interruption as currently specified (with zero target for transitional period)

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Way forward

- Responses deadline: 24 July 2006
 - Helpful to indicate:
 - Whether response is confidential, and
 - In what capacity you are responding eg, licensee, shipper, GDN etc
- Keen to receive comments on Draft IA. Intend to issue at least another IA as part of TPCR process
- EOWG to continue in the next months
- Updated Proposals due for publication in September