

## Representation - Draft Modification Report UNC 0686

### Removal of the NTS Optional Commodity Rate with adequate notice

Responses invited by: **5pm on 07 June 2019**

To: [enquiries@gasgovernance.co.uk](mailto:enquiries@gasgovernance.co.uk)

<b>Representative:</b>	Nigel Sisman
<b>Organisation:</b>	Sisman Energy Consultancy Limited
<b>Date of Representation:</b>	7 June 2019
<b>Support or oppose implementation?</b>	Support
<b>Relevant Objective:</b>	<p><b>c)</b> Positive - The respondent believes that National Grid will be in breach of its licence if this proposal is not implemented.</p> <p><b>d)</b> Positive - The respondent believes implementation will foster effective competition in the wholesale gas market to the benefit of customers. The current arrangements are likely to detract from trading at the NBP providing a perverse incentive to some to trade at the beach to avail themselves of discounted transportation arrangements available under the NTS Optional Commodity Rate.</p> <p><b>g)</b> Positive - The respondent believes implementation will remove arrangements that are non-compliant with Commission Regulation (EU) 2017/460.</p>
<b>Relevant Charging Methodology Objective:</b>	<p><b>a)</b> Positive - The respondent believes implementation will remove a major cross-subsidy and ensure that all users face charges that are more cost reflective of the overall transmission services delivered to all users.</p> <p><b>b)</b> Positive - The respondent notes NTS Optional Commodity Rate prices have not been updated for more than 20 years. The NTS Optional Commodity Rate has been materially distorting regime functioning and its use is now so widespread, and contrary to the objective of its introduction, that it is not credible to allow it to continue. Its removal will ensure a level playing across all network users. Additionally the timely implementation would address the recent development that it is now unlikely that any 0678 variant could be implemented from 1 Oct 2019.</p> <p><b>c)</b> Positive - As indicated above implementation will assist delivery of a level playing field and will encourage wholesale market activity at the NBP to the benefit of the generality of gas consumers.</p> <p><b>e)</b> Positive - The respondent believes implementation will remove an element of non-compliance with Commission Regulation (EU) 2017/460.</p>

**Reason for support/opposition: Please summarise (in one paragraph) the key reason(s)**

GB appears currently to be in the position of having an unlawful transmission tariff regime. Implementation of this proposal is assessed as removing one major area of non-compliance. Additionally implementation of the proposal will remove a major cross-subsidy. Furthermore timely implementation will reduce the risk of disputes, legal challenge and infraction procedures associated with GB's transmission charging arrangements.

**Implementation: What lead-time do you wish to see prior to implementation and why?**

The respondent recommends that this proposal is implemented from 1 October 2019.

The current arrangements are inappropriate and should not be allowed to continue. The industry has known about the fundamental problems associated with the NTS Optional Charge which necessitate its removal since 2014 and hence has been "on notice" for some considerable time. The industry should have envisaged removal based on extensive deliberations over these years and, more specifically, in the context of Modification Proposal 0636 and this proposal.

**Impacts and Costs: What analysis, development and ongoing costs would you face?**

Implementation of this proposal will create a redistribution of transmission costs across users of the system. It is important to realise that implementation will create a charging methodology that delivers pricing which is closer to that required by law and which meets the principles and objectives of the network code and National Grid's licence obligations.

Importantly domestic, and industrial and commercial consumers in the DNs will see reductions in their transmission prices. This will unwind a long running and major cross-subsidy that has persisted in the regime for many years and which National Grid has assessed as a £150m/annum cross-subsidy recently.

**Legal Text: Are you satisfied that the legal text will deliver the intent of the Solution?**

The respondent has not reviewed the legal drafting.

**Are there any errors or omissions in this Modification Report that you think should be taken into account? Include details of any impacts/costs to your organisation that are directly related to this.**

The Modification Report delivers an interesting perspective on the relative merits and challenges associated with this proposal.

By way of example the following points are indicated:

Firstly, the report cites that Ofgem's pronouncement in its Modification Proposal 0636 decision letter "It is unclear whether the envisaged benefits are likely to materialise" is likely to apply to this proposal.

This idea derives from the assertion that contracts with end-users lock in current transportation costs and that end-user tariffs will not respond to transmission charge changes. Current network users availing of NTS Optional Commodity Rate would face price increases if this proposal were implemented; some expectation of this might have reasonably been expected and so this risk should have been managed in the relevant contracts particularly given the generally large size of the sites enjoying the benefit of inappropriately cheap transportation service. For the smaller loads that might be expected to see reduced transportation charges there may indeed be some "stickiness" before the reductions feed through but this should be no reason for rejection or delay of implementation. Implementation should take place as soon as reasonably possible to ensure that the benefits of price reductions feed through to consumers as soon as possible. If this argument from the Modification Report is progressed to its logical conclusion then there can never be any change that might in any way change transportation charges to any user.

Indeed this risk is already observed in our recent industry process. The deficiencies of the current regime are more widespread than the NTS Optional Commodity Rate. Specifically the capacity zero reserve price also creates a major distortion. Removing such major distortions is likely to create major changes in transportation charging particularly if all deficiencies are to be addressed in one go. This has resulted in a reluctance to make the substantial changes needed to deliver an efficient and effective gas transmission charging regime.

Secondly the report also suggests that "Some Workgroup Participants believed the views about compliance with current EU legislation are the assertion of the Proposer of Modification 0686 only." Others, including this responder, have consistently argued that the NTS Optional Commodity Rate is not compliant. This non-compliance can reasonably be inferred based upon Ofgem's compliance assessment contained within its Modification Proposal 0621 decision letter.

The respondent concludes that very careful consideration is given to the report and that assertions contained within are thoroughly tested before being accepted as matters of fact.

The respondent has participated for many years in publicly accessible gas transmission charging meetings although it has become increasingly difficult to get objective opinion properly explored in the industry's development processes and in minutes. The respondent notes that charging matters were originally dealt with outside of the network code but with rigorous and extensive consultation processes so that the opinions of consumers and network users were appropriately input and assessed by the licenced entity and regulator. More recently the approach has been governance within the usual network code development process. However, in the opinion of the respondent, this has failed to deliver acceptable outcomes as evidenced by the inability of the industry, via the Modification Proposals 0621 and 0678 process to deliver any proposal with an implementation recommendation. It is therefore important, as a matter of urgency, that reform of the governance approach in relation to gas transmission tariffs is considered. The respondent encourages BEIS to take timely and effective action to remedy the industry's deficient governance.

Please provide below any additional analysis or information to support your representation

### **Representation in network code development process**

This response has been written to provide a domestic and smaller industrial and commercial gas consumer perspective upon this change proposal.

### **The cross-subsidy issue and transparency**

The industry has been discussing the issues associated with the NTS Optional Commodity Rate for approaching five years. It has been apparent that the NTS Optional Commodity Rate has been delivering inappropriately low transportation charges along a range of transportation routes that could not reasonably contemplate any prospect of alternative by-pass pipelines.

National Grid have indicated that the resulting cross-subsidy amounted to approximately £150m per annum. On the assumption that the benefits of the NTS Optional Commodity Rate are being passed through to those end-users associated with the NTS Optional Commodity Rate then the inflated element of other users' transportation prices reflected in normal transportation prices will mainly be shouldered by domestic and smaller industrial and commercial users in the distribution networks. Of course if the benefits of the NTS Optional Commodity Rate are not being passed through then the distortionary effect will be even larger than National Grid's cross-subsidy estimate.

It is understood that applications for the NTS Optional Commodity Rate have been made since National Grid's analysis associated with the £150m cross-subsidy was made available to the industry and indeed evidence supplied in respect of the Modification 678 consultation would suggest that the cross-subsidy might be expected to further increase. Performing analysis, however, is difficult because no information is available in the public domain about the individual routes and associated utilisations of the NTS Optional Commodity Rate. In the unfortunate event that this proposal is not implemented on 1 October 2019 then a change proposal should be raised to ensure an appropriately greater level of transparency about the uptake of the NTS Optional Commodity Rate.

### **Holistic approach**

Whilst arguments have been raised that GB transmission tariff non-compliance should be addressed with a single change it is now apparent that the industry has been unable to develop such a single proposal for timely implementation as witnessed by the industry's inability to make an implementation recommendation associated with Modification Proposals 621 and 678 or any of their alternates.

This response encourages Ofgem to implement one of the Modification Proposal 0678 alternates. Given the industry's reluctance to contemplate minor, but potentially effective, refinement of the current methodology this response advocates selection of one of the small subset of substantially compliant proposals on the table. Furthermore this response advocates a Postage Stamp methodology is chosen and so advocates a choice between Modification Proposals 0678A and 0678C. Should one of these be chosen, or Ofgem decide to direct a variant then the change should take effect from 1 October 2019. This would ensure that tariffs effective from 1 October 2019 could be considered compliant.

Should Ofgem find itself unable to recommend this approach for implementation on 1 October 2019, as seems likely, then it is essential that a first step towards compliance should be taken by implementing Modification Proposal 686 from 1 October 2019.

This is a pragmatic way forward, mitigating risk and recognises that a fully compliant implementation will create major changes for network users. The implementation of Modification Proposal 0686 will remove a major dysfunctionality in the regime and act as a helpful transition towards a fully compliant GB transmission tariff regime.

### **Large end-customer impacts**

It has to be recognised that the implementation of Modification Proposal 686 may create some major price increases for large loads situated very close to beach terminals.

From a transmission charging perspective the loss of these loads, should the cheaper service remain available, would create only a very small revenue loss. Implementation would significantly increase revenues from those currently availing of the NTS Optional Commodity Rate, but who could never realistically bypass, who would then be facing appropriate charges reflecting the underlying costs of the service they are receiving. Thus the removal of the NTS Optional Commodity Charge would deliver net benefits to those currently unable to avail themselves of that cheaper service; even if some load was lost to bypass it is inconceivable that sufficient losses would occur to cause a net detriment to those currently unable to avail of the NTS Optional Commodity Rate.

Thus implementation would deliver a more equitable recovery of the costs of service. It is acknowledged that implementation of Modification Proposal 0686 might create some risk of bypass.

But this risk is economically justified and required by law. It is important to recognise that the law does not provide for two-tier charging and that all users should pay appropriately for the benefits of connection to the NTS. It is clear that any lower charge should only apply to a lesser service, this is a clear principle established in the law.

Implementation would not necessarily force those users “off-system”. If those end-consumers cannot afford to pay for the standard service then they could raise a proposal to secure an appropriately limited service and to pay a fair rate for the service. Ofgem’s decision might be expected to stimulate such activity.

Provided the proposed service satisfies the law and network code and transmission charging requirements then a more limited service, which appropriately addresses realistic prospects of bypass, could be supported by Ofgem. There is obviously benefit in keeping loads on the system but this should be considered in the context of relevant capacity booking, flows and the resulting revenues generating a contribution to the benefit of the generality of users and as part of Ofgem’s wider responsibilities. Affording inappropriately widespread cheap access for long distance transportation serves to increase costs to those unable to avail of the cheaper service, typically the domestic and smaller industrial and commercial customers. This problem has gone on for far too long and the opportunity to eliminate this anomaly needs to be taken as soon as reasonably practical.