

Representation - Draft Modification Report

UNC 0678; 0678A; 0678B; 0678C; 0678D; 0678E; 0678F; 0678G; 0678H; 0678I; 0678J;

Amendments to Gas Transmission Charging Regime

0678	Amendments to Gas Transmission Charging Regime
0678A	Amendments to Gas Transmission Charging Regime (Postage Stamp)
0678B	Amendments to Gas Transmission Charging Regime
0678C	Amendments to Gas Transmission Charging Regime (Postage Stamp)
0678D	Amendments to Gas Transmission Charging Regime including a Cost based Optional Capacity Charge
0678E	Amendments to Gas Transmission Charging Regime – Treatment of Storage
0678F	Amendments to Gas Transmission Charging Regime – Treatment of Unprotected Entry Capacity Storage
0678G	Amendments to Gas Transmission Charging Regime including a Cost based Optional Capacity Charge
0678H	Amendments to Gas Transmission Charging Regime (Postage Stamp) including a Cost based Optional Capacity Charge
0678I	Amendments to Gas Transmission Charging Regime including Wheeling and an Ireland Security Discount
0678J	Amendments to Gas Charging Regime (Postage Stamp) including a Cost Based Optional Capacity Charge

Responses invited by: 5pm on 08 May 2019

To: enquiries@gasgovernance.co.uk

Representative:	Chris Wright																							
Organisation:	ExxonMobil																							
Date of Representation:	8 May 2019																							
Support or oppose implementation? (Please note you will be asked for your reasoning further below)	<table border="1"> <tr><td>0678</td><td>Oppose</td></tr> <tr><td>0678A</td><td>Oppose</td></tr> <tr><td>0678B</td><td>Oppose</td></tr> <tr><td>0678C</td><td>Oppose</td></tr> <tr><td>0678D</td><td>Oppose</td></tr> <tr><td>0678E</td><td>Oppose</td></tr> <tr><td>0678F</td><td>Oppose</td></tr> <tr><td>0678G</td><td>Oppose</td></tr> <tr><td>0678H</td><td>Oppose</td></tr> <tr><td>0678I</td><td>Oppose</td></tr> <tr><td>0678J</td><td>Support</td></tr> </table>		0678	Oppose	0678A	Oppose	0678B	Oppose	0678C	Oppose	0678D	Oppose	0678E	Oppose	0678F	Oppose	0678G	Oppose	0678H	Oppose	0678I	Oppose	0678J	Support
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Expression of Preference (Please note you will be asked for your reasoning further below)	0678J																							

Table of Relevant Objectives

	a) Efficient/economic operation of the pipeline system	b) Coordinated, efficient, economic operation of combined system	c) Efficient discharge of licensee's obligations	d) Securing of effective competition	e) Incentives to meet domestic supply security standards	f) Efficient implementation, administration of UNC	g) Compliance with the Regulation
0678	Negative	None	Positive	Negative	None	None	Positive
0678A	Positive	None	Positive	Negative	None	Positive	Positive
0678B	Negative	None	Positive	Positive	None	None	Positive
0678C	Positive	None	Positive	Negative	None	Positive	Positive
0678D	Positive	None	Positive	Positive	None	None	Positive
0678E	Negative	None	Positive	Negative	None	None	Positive
0678F	Negative	None	Positive	Negative	None	None	Positive
0678G	Positive	None	Positive	Positive	None	None	Positive
0678H	Positive	None	Positive	Positive	None	Positive	Positive
0678I	Negative	None	Positive	Negative	None	None	Positive
0678J	Positive	None	Positive	Positive	None	Positive	Positive

Notes on Relevant Objectives:

- a) Use of a PS RPM provides the most stable and predictable charging basis, which will best incentivise use of the NTS by shippers. Removing the NOC altogether will incentivise inefficient investment in alternative pipelines, hence a negative impact. Replacing current inappropriate NOC with an appropriate alternative (D, G, H and J) or an inappropriate alternative (B) will incentivise continued use of NTS, hence a positive impact.
- b) None of these proposals materially impact this Relevant Objective.
- c) Any proposals will enable the licensee to better discharge its obligations.
- d) Removing the NOC altogether will incentivise inefficient investment in alternative pipelines. Where this occurs, competition between shippers for end user customers will be limited, hence a negative impact. Replacing current inappropriate NOC with an appropriate alternative (D, G, H and J) or an inappropriate alternative (B) will incentivise continued use of NTS, thereby maximising the number of shippers competing for supply points, hence a positive impact.
- e) None of these proposals materially impact this Relevant Objective.
- f) We view CWD as being equal in complexity to LRMC, therefore swapping LRMC for CWD is neutral. We view PS as being significantly simpler to describe, administer and understand, with a corresponding positive impact on Relevant Objective g).
- g) Viewed as packages of changes, all proposals are more compliant than prevailing UNC charging arrangements. However, certain modification proposals contain elements that we view as non-compliant. One example is the different treatment proposed for protecting existing capacity bookings from top-up charges – some modifications propose the protection of only existing and/or future capacity at storage sites. This raises questions about compliance with Article 35 and discriminatory treatment which Ofgem will need to carefully consider when reaching a decision on implementation.

Table of Charging Methodology Relevant Objectives

	a) Cost reflective charge setting	aa) Prices set by auctions	b) Takes account of transportation business developments	c) Facilitates competition	d) Secretary of State determination	e) Compliance with the Regulation
0678	None	None	Negative	Negative	None	Positive
0678A	None	None	Positive	Negative	None	Positive
0678B	None	None	Negative	Positive	None	Positive
0678C	None	None	Positive	Negative	None	Positive
0678D	Positive	None	Negative	Positive	None	Positive
0678E	None	None	Negative	Negative	None	Positive
0678F	None	None	Negative	Negative	None	Positive
0678G	Positive	None	Negative	Positive	None	Positive
0678H	Positive	None	Positive	Positive	None	Positive
0678I	None	None	Negative	Negative	None	Positive
0678J	Positive	None	Positive	Positive	None	Positive

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

0678

Implementation would secure greater compliance with EU TAR than current arrangements. However, it would impose sub-optimal, and in some cases detrimental, arrangements on the GB gas industry.

RPM

Regarding the choice of Reference Price Methodology (RPM), all four National Grid “Future Energy Scenarios” show UK annual natural gas demand falling significantly out to 2050. This suggests that the network, which is currently largely unconstrained and with significant excess entry capacity, will demonstrate even greater ullage in future. As such, the role of capacity charging has changed from being one of sending signals for future investment, to a more straightforward revenue recovery mechanism. It is therefore generally accepted that the use of a Long Run Marginal Price methodology is no longer appropriate as a basis for setting GB gas transmission charges, and we agree with that view. Instead, modification 0678 proposes the use of Capacity Weighted Distance (CWD) as the RPM.

In its decision letter on 0621 et al, Ofgem referenced its work on the electricity targeted charging review. That review, supported by extensive and detailed analysis, highlights that in the absence of a strong future investment signal, the use of Postage Stamp (PS) charging is entirely appropriate and indeed preferable to alternatives. Further, we note that PS has been selected or is proposed as the RPM across the majority of European TSOs.

In the context of GB, PS charging is no less cost reflective than CWD, primarily for two reasons: first, historic NTS costs cannot be accurately apportioned to individual entry points or flow pattern; and secondly, CWD uses only very crude distance inputs in order to derive a distance related element. It takes no account of the distance that gas actually travels across the network, which is to an extent controlled separately by the system operator based on prevailing conditions at any one time. Therefore, while this CWD proposal is almost certainly better than LRMC as an RPM, we believe it is sub-optimal for the UK system and therefore do not support 0678 for its use of CWD.

NOC

Modification 0678 also removes the current NTS Optional Charge (NOC) arrangement. We support the principle of avoiding investments that create inefficient bypass of the NTS (the original intend of the NOC) and believe there is strong alignment across the industry on this point. However, we believe that the current NOC arrangement has become over-utilised as a cost saving tool; in the process pushing costs onto other network users and creating a situation of inappropriate cross-subsidies. It is also based on commodity charges to an extent not acceptable under TAR. However, 0678 proposes no alternative. Therefore, by removing the current NOC, 0678 is more compliant than current arrangements, but by not putting forward a replacement, compliant NOC, it introduces the threat of inefficient system by-pass. We therefore do not support 0678 for its failure to replace the unacceptable, current NOC with an acceptable NOC which we believe is available now (see Alternative modifications D, G, H, and J).

FCC

Forecasted Contracted Capacity (FCC) is a key input to the RPM calculation, and it is essential that this methodology is as rigorous as possible in order to drive accurate capacity unit pricing. However, we are concerned that the approach to setting FCC under modification 0678 is not as

refined as it might be. First, we believe it will inherently overstate anticipated annual gas flows and hence capacity bookings. This would result in an annual revenue under recovery and the need for a revenue top up charge to be applied. Second, where National Grid has flexibility in its application of FCC inputs (i.e. where it believes those inputs to be implausible) the process for selecting alternative inputs is opaque to system users. This could lead to confusion around the operation of the FCC process. We therefore do not support this aspect of 0678, and believe that 0678J better addresses the requirements of transparency and accuracy.

Treatment of existing and legacy (pre-TAR) capacity contracts

Modification 0678 proposes the netting off of existing contracts within the FCC methodology, in order to more accurately forecast future capacity booking. We support this aspect of 0678 and believe that it will serve to limit the application of inappropriate revenue top up arrangements.

0678 also proposes the protection of all legacy (pre-TAR) contracts from the application of any form of revenue top-up charge. We support this aspect of 0678. These contracts were struck on the basis that any top up charges would only apply in the event that the contracted capacity was utilised. Moving to a basis of applying top-up charges to all existing bookings would constitute a material variation in contractual terms and would mean that charges become floating, contrary to the intent of Article 35.

Additional changes

0678 proposes numerous other changes to prevailing arrangements. These include (but are not limited to): the application of a multiplier of 1 for all capacity products (i.e. the removal of discounts up to 100% for short term capacity); an interruptible discount of 10%; a 50% storage discount; and implementation as soon as reasonably practicable allowing for the required notice period for charge changes. We support these aspects of 0678.

Overall, however, we do not support the package of changes proposed by 0678.

Comments on all the 0678 Alternatives are provided below by exception.

0678A

Comments broadly as per 0678. However, while 0678A is a more appropriate modification proposal for its use of a PS RPM for the reasons discussed above under 0678, overall it still seeks to implement a sub-optimal package of changes. We therefore do not support its implementation.

0678B

Comments broadly as per 0678. However, while we welcome 0678B's intention to seek to implement an alternative NOC methodology, we are concerned that this methodology remains open to application in situations where there is no credible risk of inefficient system bypass. In doing so, it risks perpetuating the main disadvantages of the current methodology i.e. excessive and unjustified charge avoidance leading to unacceptable cross subsidies.

Overall 0678B seeks to implement a sub-optimal package of changes, and we therefore do not support its implementation.

0678C

We welcome 0678C's proposal to use a PS RPM. However, in particular we do not support its removal of the current NOC without an appropriate replacement (e.g. as proposed by D, G, H and J). While possibly of lower impact, we do not consider that an 80% storage discount has been objectively justified, nor the proposal to only protect storage capacity from top-up charges.

Overall 0678C seeks to implement a sub-optimal package of changes. We therefore do not support its implementation.

0678D

While we support 0678D for its appropriate NOC methodology, we do not support its use of CWD as a RPM.

Overall 0678D seeks to implement a sub-optimal package of changes. We therefore do not support its implementation.

0678E

We do not support 0678E's use of CWD as a RPM, and nor do we support its removal of the current NOC without an appropriate replacement (e.g. as proposed by D, G, H and J).

As with 0678C, we do not consider that an 80% storage discount has been objectively justified, nor the proposal to only protect storage capacity from top-up charges.

Overall 0678E seeks to implement a sub-optimal package of changes. We therefore do not support its implementation.

0678F

We do not support 0678F's use of CWD as a RPM, and nor do we support its removal of the current NOC without an appropriate replacement (e.g. as proposed by D, G, H and J).

As with 0678C and E, we do not consider that an 80% storage discount has been objectively justified, nor the proposal to only protect storage capacity from top-up charges.

Overall 0678E seeks to implement a sub-optimal package of changes. We therefore do not support its implementation.

0678G

While we support 0678G for its appropriate NOC methodology, we do not support its use of CWD as a RPM.

We do not consider that the proposal to only protect storage capacity from top-up charges has been objectively justified.

Overall 0678G seeks to implement a sub-optimal package of changes. We therefore do not support its implementation.

0678H

We support 0678G for its use of PS as the RPM and its appropriate NOC methodology. However, we do not consider that the proposal to only protect storage capacity from top-up charges has been objectively justified.

Overall 0678H seeks to implement a sub-optimal package of changes. We therefore do not support its implementation.

0678I

We do not support 0678I's use of CWD as a RPM.

We do not support 0678I's replacement of the current NOC methodology with a "Wheeling Charge" variant that sets a zero distance limit, which appears to be designed to apply at a single point on the GB network. In setting the zero distance limit, this proposal does not satisfy the guiding requirement that an NOC should provide incentives to avoid inefficient bypass of the NTS; we are aware of a number of examples where highly plausible bypass pipelines of up to just a few kilometres could provide users with significant cost savings compared to full NTS charges.

We are not convinced that a robust and objective case has been made in support of the proposed "Ireland Security Discount", nor indeed that this aspect has been rigorously developed. For example, it appears discriminatory in seeking to apply only to gas entered at UK Beach Terminals, to the exclusion of other (non-beach) supply sources.

Overall 0678I seeks to implement a sub-optimal package of changes. We therefore do not support its implementation.

0678J

We believe that 0678J strikes the most appropriate balance between ensuring compliance with TAR while also best meeting the current and future needs of network users.

In particular, we welcome its use of PS as the RPM, and its replacement of the current NOC with an appropriate and compliant alternative. Of all these proposals, 0678J is also the only one to effectively tackle deficiencies in the FCC methodology including the potential for opaque rule application by National Grid, which could lead uncertain outcomes, a disengagement of network users in the process, and an overstatement of expected capacity sales.

Overall 0678J seeks to implement the most optimal set of charging arrangements of any of this suit of proposals, and we support its implementation.

Implementation: *What lead-time do you wish to see prior to implementation and why? Please specify which Modification if you are highlighting any issues.*

ExxonMobil agrees with the implementation arrangements set out in mods 0678 and A, D, E, F, H and J – all of which provide for notice of revised charges as set out in the UNC.

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

0678 and A-J

ExxonMobil has incurred costs through attending development workgroups and analysing these modification proposals in order to assess their compliance with TAR, and their commercial impact on our business.

We would face further administrative costs if any of these proposals were to be implemented whereupon it would become necessary to amend existing contracts to reflect new network charging arrangements, and in some case to unwind current NOC arrangements.

Legal Text: *Are you satisfied that the Legal Text will deliver the intent of the Solutions for each Modification? Please specify which Modification if you are highlighting any issues.*

We haven't identified any issues, but we haven't undertaken a full, independent review of all of the legal text for all modification proposals.

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

0678 and A-J

No.

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

0678 and Alternatives A-J

None.

Consultation Questions Requested by the Authority

The Authority has requested that the following questions be considered by Respondents when writing their responses.

Question Number	Question
Q1.	What impact, if any, do you think tariff differentials between existing and new contracts will have on users booking behaviour?
A1.	<p>To an extent, this depends upon the level of the differentials, which would vary depending upon which (if any) of this suite of proposals is implemented. Some proposals would create greater differentials than others.</p> <p>Pricing differentials exist under prevailing arrangements, mainly due to the current charging arrangements which provide clear incentives on network users to book heavily discounted, or free, very short term capacity. These incentives will not exist under any of the 0678 et al arrangements.</p> <p>The distortive effects of the current arrangements have been well known for a number of years and have significantly disadvantaged holders of historic long term capacity bookings. We would therefore view the creation of new differentials created under the transition to a new charging regime as a temporal correction before levelling out over the next decade.</p> <p>The vast majority of network users in GB are long term players with established operations. Some will have benefitted historically from opportunities offered by large capacity discounts, while others will have effectively been penalised by decisions made many years ago to buy long term capacity. We are not aware of gas shippers or producers exiting the GB market on the basis of these historic distortions.</p> <p>Very roughly, we believe the changes proposed will reverse this situation. Any new differentials created at this stage will, of course, diminish over time as existing capacity contracts expire. Going forward, all shippers would have to book new capacity with much lower differentials than currently exist. Therefore, in the longer term, we believe that the effects of these proposed changes will be limited.</p> <p>However, there is a further question about the <u>absolute</u> levels of capacity prices that could be introduced, particularly at St Fergus under a CWD RPM. Here we have far greater concerns. Significant volumes of Norwegian gas is landed at St Fergus. However these volumes should be viewed as discretionary inasmuch as Norwegian producers can choose to route some of that gas to different markets should the UK prove to be an unattractive destination. There are also clear implications for future development on the UKCS, or indeed the continuation of existing production, under high entry point capacity price scenarios. This would be at odds with the objectives of MER UK. Such issues would to some extent be addressed by using PS rather than CWD.</p>
Q2.	What date should the changes proposed by the modifications become effective and why?
A2.	<p>TAR is very clear in its requirements for implementation/effective dates. However, it seems extremely unlikely that GB can now achieve a compliant effective date while still following legal and other due process requirements; i.e. a robust an impact assessment, relevant consultation processes, and required notice periods for changes to charges. The choice is then one of changes becoming effective as soon as reasonably practicable, or delaying the</p>

	<p>effects of changes until 1 October 2020 in order to avoid a mid-gas year change.</p> <p>Ofgem offered guidance on this point in its decision on 0621 et al, through its rejection of a concept of a transition period. We would view any delay beyond what is necessary in order to complete all due process steps, as being a de facto transition period, and therefore inappropriate for the reasons that Ofgem set out in its decision letter of 20 December 2018.</p>
Q3.	<p>The proposals have different specific capacity discounts for storage sites. What level of storage discount do you consider is appropriate and can you provide clear justification if the discount is greater than 50%.</p>
A3.	<p>Any discount for storage sites should be justified on objective grounds relating solely to network costs. It should not be justified on grounds of a financial support mechanism for commercial gas storage activities. Concerns, for example about gas supply security in the event that storage facilities become uneconomic and close down, should be considered separately, and dealt with through alternative mechanisms that do not give rise to distortive network charges if this is deemed to be appropriate.</p> <p>We are not convinced that a discount level above the minimum required under TAR i.e. 50%, has been justified. While there may be a case that network costs are reduced by certain storage operations, the same could also be true for embedded gas production facilities which are not set to benefit from any form of differentiated discount compared to storage facilities.</p>
Q4.	<p>Can you provide reasons why an NTS Optional Charge is or is not justified? If you consider an NTS Optional Charge is justified, which proposal do you prefer and why is it compliant with TAR NC?</p>
A4.	<p>Encouraging use of the network directly furthers relevant objective (a), “Efficient and economic operation of the pipeline system”. This is because fixed network costs are recovered from a greater number of users and/or throughput. Establishing an appropriate NOC encourages use of the network as opposed to building a competing pipeline and therefore better facilitates relevant objective (a).</p> <p>Similarly, relevant objective (d), “Securing effective competition between relevant shippers” is better facilitated through the use of an appropriate NOC mechanism. This is because it would encourage shippers to compete against each other where entry and exit points are adjacent, rather than denying competition through the development of a private pipeline.</p> <p>Four of these modifications – 0678 D, G, H and J – all propose the same optional charging methodology. Having attended workgroup discussions, we believe that this proposal has been developed to the point that it could not reasonably be improved upon through the ongoing 0670R process, and is now suitable for inclusion in the 0678 process. Further, we believe it effectively tackles all of the objections raised by Ofgem to the 0621 NOC proposals.</p> <p>In particular, this NOC methodology contains an implicit maximum utilisation distance which mimics the drivers relevant to determining the appropriateness of developing a competing pipeline. This is what has been referred to as the “genuine risk of by-pass”. It also charges on a capacity rather than commodity basis.</p> <p>We therefore support this methodology and believe that it is appropriate in all aspects.</p> <p>We believe that the methodology proposed under 0678B would lead to utilisation that exceeds the genuine threat of inefficient by-pass. It would be implausible to contemplate the construction of an economically viable private pipeline on many of the routes that would be opened up (or would remain open) under this proposal.</p> <p>By contrast, the “wheeling” option proposed under 0678I will exclude many scenarios where a genuine threat of by-pass exists.</p>

Q5.	Do you consider the proposals to be compliant with relevant legally binding decisions of the European Commission and/or the Agency for the Co-Operation of Energy Regulators?
A5	We have no reason to believe that these proposal are non-compliant. However, the TAR process is still relatively new, and regulatory decisions are continuing to shape general understanding of what is and is not compliant/acceptable. For example, we did not consider that all of the 0621 modifications were non-compliant but these were ultimately rejected as such.
Q6.	It is proposed that National Grid Gas may review or update the Forecasted Contracted Capacity (FCC) Methodology following consultation with stakeholders, unless Ofgem (upon application by any Shipper or Distribution Network Operator) directs that the change is not made as per its powers under Standard Special Condition A11(18) of National Grid's Licence. Do you believe that this governance framework is fit for purpose? Please provide reasons for your answer.
A6.	We believe that there are sufficient safeguards built into this process to make it a suitable governance arrangement.