

**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](mailto:enquiries@gasgovernance.co.uk)

<b>Representative:</b>	William Webster												
<b>Organisation:</b>	Oil and Gas UK												
<b>Date of Representation:</b>	8 May 2019												
<b>Support or oppose implementation?</b> (Please note you will be asked for your reasoning further below)	<table border="1"> <tr><td>0678</td></tr> <tr><td>0678A</td></tr> <tr><td>0678B</td></tr> <tr><td>0678C</td></tr> <tr><td>0678D</td></tr> <tr><td>0678E</td></tr> <tr><td>0678F</td></tr> <tr><td>0678G</td></tr> <tr><td>0678H</td></tr> <tr><td>0678I</td></tr> <tr><td>0678J</td></tr> </table>	0678	0678A	0678B	0678C	0678D	0678E	0678F	0678G	0678H	0678I	0678J	<p>No individual alternate is favoured unanimously by our members but general comments are provided on the key issues below, followed by a one paragraph summary of views on each alternate.</p>
0678													
0678A													
0678B													
0678C													
0678D													
0678E													
0678F													
0678G													
0678H													
0678I													
0678J													
<b>Expression of Preference</b> (Please note you will be asked for your reasoning further below)	No single preference.												

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

### **About Oil and Gas UK**

Oil & Gas UK is the leading representative organisation for the UK offshore oil and gas industry. Its membership comprises the main oil and gas production business in the UKCS and around 300 contractor companies right across the UK. The submission below provides further explanation of Oil and Gas UK position on the 0678 modification and the individual alternates.

### **Ofgem response to 0621**

In its letter of 20 December 2018 Ofgem set out its view that neither modification 0621 nor any of the alternate modification proposals were consistent with the TAR network code. Ofgem's decision highlighted a number of key points with respect to compliance with the which are, as a consequence, not discussed in this response.

- The use of Obligated Capacity as a basis for the calculation of tariffs was judged by Ofgem as not consistent with the TAR Code which requires the reference methodology to be based on forecast contracted capacity (FCC). Ofgem noted that OC would be a poor proxy for FCC based on current and expected future use of the network. Ofgem also rejected the concept of a transition period which it noted was not provided for in the TAR code.
- The retention of a commodity charge for the purposes of revenue recovery was considered as unlikely to be consistent with the TAR code especially given the scale of likely under recovery using the OC values. The TAR code only allows for commodity-based charges "as an exception". Likewise, the possibility of a commodity based optional short haul charge was also evaluated as inconsistent with the TAR network code.
- Ofgem considered that Article 35 could provide certainty and protection for historical bookings made before the entry into force of the TAR Code (6 April 2017) but would not apply to any so-called "interim" contracts entered into between that date and the implementation in the UK.

Ofgem's decision letter contained the implicit requirement for industry to recommence a modification process that would deliver compliance with the TAR code. This led to Modification 0678 that was raised by National Grid on 17 January 2019 and was granted "urgent" status by Ofgem on 25 January 2019.

### **Remaining Issues for Oil and Gas UK members in 0678**

National Grid Gas ("NGG") as transmission system operator has put forward Modification 0678 following Ofgem's decision and there are 10 alternates. The differences between these alternates can be summarised under five main topics.

#### **a. Application of CWD versus postalised charges**

Capacity Weighted Distance ("CWD") is noted in the TAR as a suitable reference methodology although there is flexibility to use alternative reference methodologies such as postalised charges. Under CWD the weighted average distance for each entry point (or cluster of entry points) to each exit point (or cluster of exit points) is determined using a distance matrix. The rationale for CWD is that it moves away from the largely obsolete LRMC based system currently in place while still retaining a distance related element that looks to represent the costs implied by different users of the network.

The argument for maintaining some form of locational signal could be appropriate to the extent that it was thought that:

- a. congestion or other costs such as maintenance can be avoided in future; and
- b. businesses are able to respond to a stable methodology in deciding which entry and exit points to use.

The general view among Oil and Gas UK members is that these arguments are less convincing given the lack of systematic congestion on the network, and the limited scope for some network users to respond to locational signals.

The main alternative, put forward in a number of the alternates, is to move to postalised charges where all entry and all exit points pay the same capacity-based charge. To some extent this reflects the outcome of the current charging regime since many participants have, over time, increasingly taken advantage of the possibility to book interruptible capacity at zero capacity charge. This has led to the bulk of transmission revenue being collected via a postalised commodity charge.

The main rationale for a postalised scheme is the increasingly uncertainty which points to there no longer being a predictable and prevailing flow of gas in the network. Indeed, the main elements of expenditure expected during RII02 are to support overall flexibility and capability of the network *as a whole*.

Likewise, another important feature from a consumers' perspective is the capability of the national network to deliver security of supply in more extreme conditions as evidenced by the experiences during winter 2017-18. In this context, it can be argued that a postalised methodology better supports competition, in the interests of consumers, since it provides equal access to the "virtual balancing point" and avoids giving disadvantages to particular sources of gas which, eventually, may result in less diverse sources of supply.

A final case for postalisation is that shippers using peripheral entry points such as St Fergus are unlikely to be able to respond easily to shift production which will be based on long term investment in UKCS. Distance related charges are therefore inconsistent with other government objectives such as MERUK as higher charges at UKCS entry points will make MERUK more difficult to deliver. In this regard, it is notable that most EU Member States have chosen to use a postalised system of charges<sup>1</sup> and that only three have, so far, opted to use CWD. Of these Member States, all three have a chosen an entry/exit split which allocates a lower than 50% share to Entry. So, it is possible that using CWD with a 50:50 split would unduly penalise UK producers and potentially distort competition across the EU.

***Overall, the case for using CWD as a reference methodology is not particularly strong with the risk of reducing and distorting competition to the detriment of consumers and damaging other policy objectives such as MERUK. Oil and Gas UK therefore favours postalised charges.***

**b. Discounts for storage and interconnectors etc.**

The TAR network code already requires a 50% discount to be given at charging points relating to storage facilities. The rationale for this is that without the discount users will potentially be obliged to pay for exit and entry at the site of the storage facility and that this is not cost reflective. Further analysis of the charges being paid by users of storage, particularly in the UK context have been made to justify a larger discount of 80% as reflected in alternates C, E and F.

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<sup>1</sup> See IOGP analysis in Annex

***Oil and Gas UK would generally not favour modifications or alternates that go beyond the minimum discounts required by the TAR code unless a clear case can be made on a cost-reflectivity basis. As a general principle, all sources of gas should face the same charging structure.***

#### **c. Revenue Recovery from Existing Contracts**

Many network users have longer term bookings as part of their commercial strategies and in line with the prevailing regulatory regime. These are discussed in the Network Code, Article 35, with a requirement that “this Regulation shall not affect the levels of transmission tariffs resulting from contracts or capacity bookings concluded before 6 April 2017 where such contracts or capacity bookings foresee no change in the levels of the capacity- and/or commodity-based transmission tariffs.” A number of Oil and Gas UK members consider that this would rule out any application of the capacity-based adjustment to charges to deal with revenue recovery. This is reflected in 0678 and alternates 0678A, B, D, I and J.

Meanwhile 0678C, E, F, G and H would treat existing and new contracts in a similar way with only capacity at storage connection points being exempt from revenue recovery. The rationale for this is that exemption of existing contracts would treat holders of capacity unduly favourably compared with new bookings. Some companies highlight the potentially very large differentials between charges for providing the same service at certain entry and exit points that may arise. They argue that this regime better reflects the code objectives with respect to, for example, competition.

***Oil and Gas UK does not have a collective view on this topic which will largely come down to a question of legal interpretation of the TAR NC.***

#### **d. Optional short haul tariff**

The shorthaul tariff is currently available to all users and was originally designed as an incentive to avoid inefficient investment in dedicated pipelines where the associated flow would bypass the NTS. Upon requesting the OCC an entry/exit site specific rate is calculated by NGG providing an alternative charge to NTS entry/exit TO and SO commodity charges. Over time the calculation parameters have not been updated and the shorthaul tariff is increasingly attractive, even for relatively long distances.

The NGC proposal does not include a short haul arrangement although a separate workgroup process (0670R) is currently underway to review the arrangements. By contrast, Alternates 0678B, D, E, H and J all contain some form of capacity based optional charge. Meanwhile 0678I proposing a point-to-point “wheeling” tariff for gas transiting across the UK into the neighbouring Irish market.

The optional short haul tariff is designed to avoid a situation where network users have the incentive to by-pass the transmission system by building a separate connection to the entry point. This could potentially lead to the undermining the integrity of the network and the NBP as a liquid wholesale market. Oil and Gas UK Members continue to view some form of shorthaul arrangements as necessary particularly if a CWD based methodology is adopted which will exaggerate the incentives for bypassing the national network.

***Oil and Gas UK supports the continued use of a short haul element to tariffs but opposes the concept of a “wheeling charge”.***

**e. Forecast Contracted Capacity (“FCC”)**

Following Ofgem’s decision, NGC have developed a methodology for calculating FCC based on existing bookings and historical flows to make a projection of contracted capacity in the following year. NGC propose that the FCC methodology is not included in the UNC Code itself, rather that it is review or updated by National Grid following consultation with stakeholders, unless Ofgem specifically intervenes. Other alternates such as 0678C and 0678J propose that FCC is included in the UNC with the normal oversight from the Industry Group to govern any changes. The main argument for not including FCC is that NGC expect to make iterative changes to reflect experience with the new methodology. However, on balance most Oil and Gas UK members would prefer the FCC methodology to be part of the code since changes are likely to have a material and differential impact on tariffs. In this regard, it is notable that, under CWD, the FCC methodology requires a forecast to be made at every entry and exit point. This make inaccuracies and distributional effects more likely. By contrast, postalised charging would give a simpler task to NGC in forecasting total amounts of capacity to be booked and make changes to FCC less impact on individual businesses and potentially justify a simpler governance process.

***Oil and Gas UK would prefer the FCC to be included in the UNC.***

**Oil and Gas UK  
May 2019**

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

**0678 (NGC)**

The underlying 0678 modification, on which all the other alternates are based, uses CWD as the reference methodology to produce a set of capacity based locational charges. The CWD model will be based on estimates of forecast contracted capacity (FCC) that would be determined outside the normal UNC code governance process. The modification does not include any form of optional charge for shorthaul.

Although this charging structure provides for compliance with the TAR network code, the use of the CWD model as a long-term basis for charging is considered a *negative* feature in that it is questionable from the perspective of cost reflectivity given the current and future unpredictable nature of flows in the transmission network. It is also considered that, the locational signals provided by the distance-based regime do not provide sufficient support to the need for diverse sources of supply for consumers and the government policy objective of maximising economic recovery from the UKCS (MERUK).

In additional, the absence of a shorthaul tariff is also viewed *negatively* in that it could well lead to instability in both charges and market outcomes as a result of increased incentives on network users to bypass the transmission network or transport gas elsewhere in European markets in preference to the UK. The complexity of the CWD calculation also makes the estimation of FCC more difficult and, again this may make charges and outcomes unstable.

Modification 0678 does not apply capacity-based revenue recovery to existing contracts. Some members see this as essential to compliance with the TAR code while others consider the potentially large differences in charges for the same service to be negative for fostering of competition between network users.

**0678A (RWE)**

The alternate 0678A is largely the same as 0678 but with the reference methodology based on a postalised capacity-based charge rather than CWD. Our members consider this to be *positive* as it will provide for a more predictable and stable basis for charging for the future operation of the network without significant expected capacity constraints (particularly for entry). It also makes estimating FCC much simpler and is likely to produce greater stability for charges.

The postalised model also corresponds *positively* with objectives related to network operation and security of supply given that it charges an equal entry fee to all potential sources of supply to the market. Although there is no optional charge, a uniform charging structure is likely to make the incentive to bypass the GB network weaker and make for more stable outcomes.

As with 0678, this alternate does not apply capacity-based revenue recovery to existing contracts which some members view as a *negative* feature while others consider it a legal requirement.

#### 0678B (Centrica)

The alternate 0678B is largely the same as 0678 including the reference price methodology as CWD. The same *negative* comments therefore apply to this alternate as for the 0678 Modification in terms of its potential questionable cost reflectivity and the complexity and potential instability of the FCC estimation.

0678B does, however, include a capacity based optional charge for shorthaul which is a *positive* feature, mitigating some of the adverse impacts and avoiding unstable outcomes that would result from potential bypassing of the GB transmission grid and is therefore preferable to 0678 without the optional charge.

#### 0678C (SSE)

The alternate 0678C is consistent with 0678A (postage stamp) and in addition requires the FCC methodology to be included in the UNC Code governance process rather than being a separate process. Both of these are viewed *positively*, and the same comments made in response to 0678A apply in this case and, on balance, the inclusion of the FCC into a common process is preferable.

The alternate also includes an 80% discount for storage entry and exit points which is a *negative* feature for Oil and Gas UK but with a relatively low impact.

Finally, the modification allows for revenue recovery also to be made from existing contracts with only storage connection points excluded. Some members see this as a *negative* feature and potentially inconsistent with Article 35 of the TAR Code. Others consider, however, that this will produce more competitive outcomes in terms of charges and consider it a *positive* feature.

#### 0678D (ENI)

This model is largely consistent with 0678B using CWD as the reference price methodology and including an optional charge for shorthaul. The main difference with 0678B is the methodology used to derive the optional charge. The same *negative* comments apply with respect to the use of CWD and the potentially *positive* mitigating effects of continuing with an optional shorthaul charge.

#### 0678E (Gateway)

This model is identical to 0678 but also includes a higher 80% discount as set out in 0678C. The same *negative* comments therefore apply as for 0678 given that this modification both includes CWD and removes the optional charge.



#### 0678F (Storengy)

This model is identical to 0678E but as well as the higher 80% discount as set out in 0678C and 0678E is also introduces additional rights for users to cancel historical bookings in certain circumstances. The same *negative* comments therefore apply as for 0678 given that this modification both includes CWD and removes the optional charge.

With respect to the proposal to allow for users to cancel historical bookings, this would be a legal question.

#### 0678G (Vitol)

This model is similar to 0678D, having the same reference charge method (CWD) and optional charge calculation. The same *negative* comments apply with respect to the use of CWD and the potentially *positive* mitigating effects of continuing with an optional shorthaul charge.

In addition, the alternate also allows for revenue recovery from holders of existing contracts which, as discussed above, members have contrasting views.

#### 0678H (EPUK)

This model is the same as 0678G but with postage stamp as the reference price methodology which is considered more *positively* by members with similar *positive* views regarding the retention of an optional short haul charge.

Although the same comments about existing contracts apply as for 0678G given that this modification allows for capacity based revenue recovery for holders of existing contracts.

#### 0678I (Gazprom)

This alternate is consistent with 0678 but also includes a “wheeling charge” relating to gas being transported to Ireland allowing for a 95% discount. As well as the *negative* comments relating to 0678, the reasons for a wheeling element to charges seem to be poorly justified in relation to the TAR Code and the UNC objectives and this is also viewed *negatively*.

#### 0678J (South Hook)

This alternate is similar to 0678C in that it includes postage stamp as the reference price methodology and also retains the optional charge. Both of these are considered *positively* by members,

The alternate also allows for continued protection of existing contracted bookings on which there are conflicting views.

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

A 1st October start is necessary to reflect the start of a new gas year. Mid-year changes are highly disruptive to the network.

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

Not applicable to trade association. Please see submissions from individual companies.

**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.*

No comments

**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.*

No comments

**Annex: Summary tariff methodologies submitted by national regulators and approved by ACER**

## #8: Internal Energy Market (3)

- Status NC TAR implementation ([link](#)):

	Country/system	Proposed method	Entry/exit-split
1	Netherlands	postage stamp	50/50 ?
2	Sweden	postage stamp	0/100
3	Northern Ireland	postage stamp	output
4	Romania	postage stamp	50/50
5	Denmark	postage stamp	output
6	Portugal	modified CWD	40/60
7	Slovenia	matrix	16/84
8	Poland	postage stamp	50/50
9	Poland TGPS transit	capacity weighted distance (CWD)	51.5/48.5
10	IUK	other	
11	Belgium	CWD	33/67
12	Greece	postage stamp	50/50
13	Germany	postage stamp	38/62 & 32/68
14	Italy	CWD	28/72
15	Czech Republic	CWD	20.35/79.65
16	Slovakia	postage stamp	50/50
17	Hungary	postage stamp	40/60
18	Ireland	matrix	33/67
19	Croatia	postage stamp	60/40
20	Great Britain		
21	Austria	virtual point-based	20/80
22	Lithuania	postage stamp / transit	70/30
23	BBL	other	-