

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:	David Mitchell	
Organisation:	Scotland Gas Networks and Southern Gas Networks	
Date of Representation:	8 th May 2019	
Support or oppose implementation? (Please note you will be asked for your reasoning further below)	0678	Oppose
	0678A	Oppose
	0678B	Oppose
	0678C	Oppose
	0678D	Oppose
	0678E	Oppose
	0678F	Oppose
	0678G	Oppose
	0678H	Oppose
	0678I	Oppose
	0678J	Oppose
Expression of Preference (Please note you will be asked for your reasoning further below)	<p><i>If EITHER 0678; 0678A; 0678B; 0678C; 0678D; 0678E; 0678F; 0678G; 0678H; 0678I OR 0678J were to be implemented, which <u>ONE</u> Modification would be your preference?</i></p> <p>SGN has no preferred modification due to the reasons detailed in the response.</p>	

**Standard Relevant
Objective:**

0678

a)	Negative
b)	Negative
c)	Negative
d)	Negative
e)	Negative
f)	Negative
g)	Negative

0678A

a)	Negative
b)	Negative
c)	Negative
d)	Negative
e)	Negative
f)	Negative
g)	Negative

0678B

a)	Negative
b)	Negative
c)	Negative
d)	Negative
e)	Negative
f)	Negative
g)	Negative

**Standard Relevant
Objective (continued):**

0678C

a)	Negative
b)	Negative
c)	Negative
d)	Negative
e)	Negative
f)	Negative
g)	Negative

0678D

a)	Negative
b)	Negative
c)	Negative
d)	Negative
e)	Negative
f)	Negative
g)	Negative

0678E

a)	Negative
b)	Negative
c)	Negative
d)	Negative
e)	Negative
f)	Negative
g)	Negative

**Standard Relevant
Objective (continued):**

0678F

a)	Negative
b)	Negative
c)	Negative
d)	Negative
e)	Negative
f)	Negative
g)	Negative

0678G

a)	Negative
b)	Negative
c)	Negative
d)	Negative
e)	Negative
f)	Negative
g)	Negative

0678H

a)	Negative
b)	Negative
c)	Negative
d)	Negative
e)	Negative
f)	Negative
g)	Negative

Standard Relevant Objective (continued):

0678I	
a)	Negative
b)	Negative
c)	Negative
d)	Negative
e)	Negative
f)	Negative
g)	Negative

0678J	
a)	Negative
b)	Negative
c)	Negative
d)	Negative
e)	Negative
f)	Negative
g)	Negative

Charging Methodology Relevant Objective:

0678	
a)	Negative
aa)	Negative
b)	Negative
c)	Negative
d)	Negative
e)	Negative

0678A	
a)	Negative
aa)	Negative
b)	Negative
c)	Negative
d)	Negative
e)	Negative

**Charging Methodology
Relevant Objective
(continued):**

0678B	
a)	Negative
aa)	Negative
b)	Negative
c)	Negative
d)	Negative
e)	Negative

0678C	
a)	Negative
aa)	Negative
b)	Negative
c)	Negative
d)	Negative
e)	Negative

0678D	
a)	Negative
aa)	Negative
b)	Negative
c)	Negative
d)	Negative
e)	Negative

**Charging Methodology
Relevant Objective
(continued):**

0678E	
a)	Negative
aa)	Negative
b)	Negative
c)	Negative
d)	Negative
e)	Negative

0678F	
a)	Negative
aa)	Negative
b)	Negative
c)	Negative
d)	Negative
e)	Negative

0678G	
a)	Negative
aa)	Negative
b)	Negative
c)	Negative
d)	Negative
e)	Negative

**Charging Methodology
Relevant Objective
(continued):**

0678H	
a)	Negative
aa)	Negative
b)	Negative
c)	Negative
d)	Negative
e)	Negative

0678I	
a)	Negative
aa)	Negative
b)	Negative
c)	Negative
d)	Negative
e)	Negative

0678J	
a)	Negative
aa)	Negative
b)	Negative
c)	Negative
d)	Negative
e)	Negative

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

SGN does not feel that it is able to support any of the modifications.

This is primarily due to the predicted customer impact of the proposals. We also have concerns that neither the CWD model or the postage stamp models are cost reflective. In addition, due to the tight timescales imposed, most proposers have not produced sensitivity tools to enable independent analysis to be performed. Under any circumstances we feel we would have difficulty supporting a modification when we are unable to produce our own analysis of the impacts.

We have provided further detail in relation to our position as below. Please note that given our opposition to all proposals, we will not be providing individual comments on either the original proposal or the alternates.

Capacity- Weighted Distance Model

Currently Shippers on GDN networks pay exit capacity charges generated by the Long Range Marginal Cost model (LRMC) which is reflective of the actual relationship (distance) between the entry facility and offtake. We consider the current distance calculation used by the LRMC model to be more cost reflective than any of the above proposals, as it is reflective of actual system usage and the operational relationship between entry and exit. As it stands we do not believe that where proposed the CWD model improves on this position.

As an illustration, the table below details the physical point to point distance between the entry facility and the offtake. It also highlights the average distance between the offtake and every entry facility on the basis of the distance calculation which would be used by CWD (excludes capacity weighting).

Illustration of the distance assumption between entry and offtake

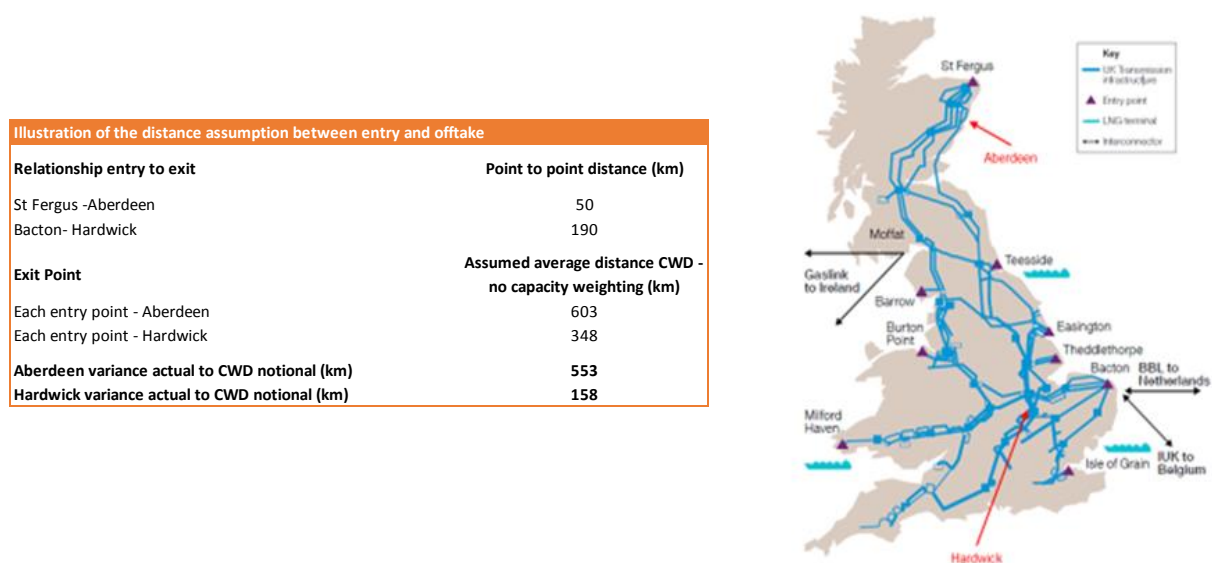
Relationship entry to exit	Point to point distance (km)
St Fergus -Aberdeen	50
Bacton- Hardwick	190
Exit Point	Assumed average distance CWD - no capacity weighting (km)
Each entry point - Aberdeen	603
Each entry point - Hardwick	348
Aberdeen variance actual to CWD notional (km)	553
Hardwick variance actual to CWD notional (km)	158

As illustrated in the table above, the CWD assumes a distance which is used to generate charges for Aberdeen offtake which are 11 times greater than the actual physical distance between the entry facility and offtake. In comparison, the distance for Hardwick offtake is 0.8 greater than the actual physical distance. This demonstrates that the use of CWD creates a greater disconnect between actual system usage for those offtakes located at an extremity in comparison to those which are within the hub of entry facilities in southern and central England. This results in charges which are not cost reflective.

Furthermore, the CWD model does not recognise the current operational constraints which restrict the flow of gas from entry facilities in the South of England to Scotland offtakes. These constraints physically prevent the hypothetical flow of gas which underpins the CWD, and as such precludes the CWD model from being reflected in reality.

In addition to the physical constraints on the system, we experience a continued drive from NTS to accept reduced assured offtake pressures in Scotland. Further information is available in National Grid's 10 year statement, which details these system constraints in section 3.4 "System Capability" https://www.nationalgrid.com/sites/default/files/documents/GTYS%202017_3.pdf

Dynamic operational factors such as the above further impact the physical feasibility of gas flow through the network, and therefore exacerbate the degree to which CWD does not reflect the network.



Cost Reflectivity

SGN does not feel that it has been sufficiently demonstrated that the key elements driving the proposals would result in total charge levels reflecting the bookings made on the system.

SGN's key concern is the lack of predictability in behavioural changes impacting Forecast Contracted Capacity (FCC), a single pot for revenue recovery and K. The proposals are making fundamental changes to the charging structure, yet little evidence has been provided to demonstrate that the revenue required associated with the booking reflects the actual revenue recovered. Cost reflectivity would be enhanced if any over/under recovery of revenue was targeted at the exit point that created it. Under current proposals any over/under recovery is smeared across all exit points regardless of where it was created and therefore provides less cost reflectivity and increased volatility, particularly at exit points at the extremes of the network such as Scotland.

Currently Shippers on GDN networks pay NTS exit commodity charges and exit capacity charges levied by National Grid on a pass-through basis by GDNs.

Due to the TAR NC requirements for the charging methodology to be largely one based on revenue recovery through capacity charges exit commodity charges to Shippers will cease, with NTS exit revenue instead being recovered through capacity charges as passed through by the GDNs. The impact of this approach will be a significant increase in these capacity charges, yet with little visibility available to the

customer as to the source of the charges and relevant increases. DN's will pick up approximately 65% of the Exit revenue costs though they only account for 50% of the bookings.

Postage Stamp Model

Similarly, we do not consider that a postage stamp model is an improvement upon the current arrangements. Whilst a postage stamp model represents a more equitable arrangement, in that all customers pay the same, similar to CWD this cannot be described as a cost reflective model given that the model does account for operational entry to the network based on optimised supply and demand, as per the existing LMRC model.

Price Volatility

We have undertaken and published analysis where possible, as mentioned earlier, unlike 0621 most proposers have not included a sensitivity tool to enable the production of independent analysis. The analysis that we have undertaken highlights that the proposed changes are likely to result in exit capacity charge levels which, in the short to medium term, are volatile and would be a significant step change from those produced using the current methodology.

Given that these proposals are a fundamental change from the current methodology we consider there to be a high probability that unquantified factors will impact stability and predictability of charges.

Due to the removal of the transitional stage proposed in MOD0621 there will be no visibility of any behavioural changes resulting from the new charging methodology nor indeed how these will impact the new proposed FCC.

As National Grid and GDNs have the same publication deadlines, SGN will have little or no certainty in relation to National Grid's pricing requirements and as such will be required to estimate the costs. This may further introduce volatility into the price-setting process, due to a likely requirement to revise and reconcile these prices once the confirmed NTS position is available.

In developing the Modification proposals, SGN feels that it is worth noting that the challenge and review process has been very limited due to the time constraints imposed. As such, there is a risk that any implemented solution may be subject to further challenge and refinement, potentially resulting in further modifications which could add to the price volatility. This is further compounded by the fact GD2 is nearing and the assumed reset of DN allowance will need to be finalised during 2020. This will be difficult as any behavioural changes, alternate MOD's or changes to FCC are likely to be post resetting of allowances, further driving price volatility.

Prior to the implementation of DNPC06 in October 2012, National Grid levied Exit Capacity Charges (ECN) directly to shippers. These alternative arrangements resulted in GDN's allowances being adjusted to reflect the NTS costs in respect of the offtakes within the distribution network. The introduction of this GDN charge was considered to facilitate improved cost reflectivity and predictability. The GDN's now levy the charges payable directly to DN shippers on National Grid's behalf with any variance between the set allowance and actual cost being trued-up on a two-year lag. On reviewing the basis on which charge was established, SGN strongly believes that license and/or UNC changes are required to remove/limit the price volatility passed through to customers and would argue that DN's are no longer best placed to recover these costs.

The table below illustrates the potential charging impact of 0678 on Exit Capacity Charges (ECN) in Scotland, highlighting the step change from the current charge levels in 2020/21 (two year lag from 2018/19) to the proposed new charges in 2021/22 and beyond. Note that SGN has no control of how these charges are passed on to end users.

ECN Charge Impact Scotland					
£'s Average Customer Bill	Avg SOQ (Kwh)	2020/21	2021/22	2022/23	2023/24
0 - 73.2 Kwh	113	£0.04	£13	£18	£9
73.2 - 732 Kwh	1,529	£0.6	£179	£242	£126
732 - 5,861 Kwh	11,231	£4	£1,314	£1,774	£927
> 5,861 Kwh	190,323	£69	£22,264	£30,062	£15,717
Large User	1,500,000	£548	£175,474	£237,580	£123,872

Customer Impacts

Throughout development of the modification proposals and previously under Mod 0621, SGN has flagged the potential customer impact associated with the new arrangements.

We foresee that we will have difficulty in messaging these impacts to customers when the proposals are signposting a message of improved stability. SGN feels that insufficient consideration has been given to the processes/timelines required to support the introduction of the new methodology and therefore the associated pricing volatility.

Should Mod 0678 or one of its alternates be implemented then SGN believes that Ofgem has a role to play in communicating the substantial increases in costs faced by consumers and businesses, especially those in Scotland. This message will be complex given the substantial proportion of the UK gas supply being beached in Scotland.

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

In the likelihood that Ofgem's consultation process encroaches near to or post October 2019 we feel the implementation date should be at the earliest October 2020. This would give the industry time to adjust to the significant changes to come. Auctions in relation to October 2019 would have already taken place and large users would have factored energy costs into their prices so any increase would impact their bottom line. From an SGN perspective an October 2021 implementation date would be preferred as this would coincide with the assumed resetting of NTS cost allowances in GD2 and temper some of the inevitable cost/customer impact volatility we will see in the short/medium term.

In addition, an October 2020 or 2021 date would give SGN, along with Ofgem, additional time to message the significant customer impacts.

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

We do not expect SGN to incur additional cost for capacity bookings as a result of the proposal change to charge for 'off-peak capacity'. We expect to have sufficient capacity available at each offtake to supply 1 in 20 peak demand. Should we experience any unexpected increases in demand at local level, operational constraints/faults or special operations requiring additional capacity, we will utilise both the daily and long term flow swap process. However, regarding cost, we may experience funding impacts due to the two year cost recovery lag.

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 believe that the legal text will deliver the intent of the solutions.

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.*

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

Below is analysis SGN provided in the workgroup report on 02 April 2019 as part of a joint DN response. The analysis highlights the cost and customer impact for both 0678 (CWD) and 0678A (Postage Stamp), it also summarises our concerns around both methodologies:-

SGN has carried out analysis as requested under section 4.15 of the workgroup report for the both Scotland and Southern networks. The analysis was completed for modification 0678 (CWD) and 0678A (Postage Stamp) using version 3.0 of the sensitivity tool.

The analysis assumes the new methodology impacts costs from October 2019. 2018/19 is included in the cost analysis as this is the last full year under the existing methodology (LMRC), so is a comparison vs the new proposed methodologies. Due to the DN tariff year running from April to March, the 2019/20 tariff year sees six months under LMRC and six months under the proposed new methodology. 2020/21 is the first full year impacted by the change.

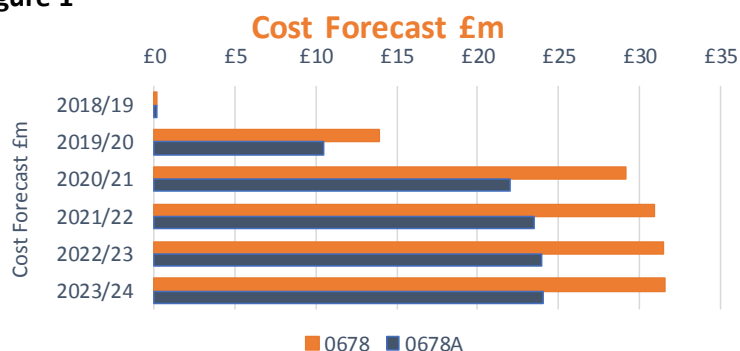
NTS costs are a pass-through item for DN's, any increase/decrease in NTS costs will flow through to shippers on a two year lag mechanism.

The commentary below relates to the joint DN presentation from the 2 April 2019 workgroup.

What the results actually mean to the Scotland costs:-

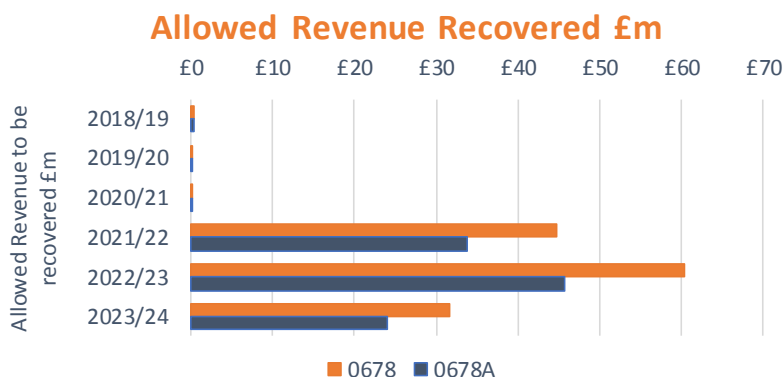
As you can see from the presentation and subsequent chart below (Figure 1) forecast costs increase substantially under the proposed new methodologies, from £0.2m (LMRC) in 2018/19 to £29m (0678) and £22m (0678A) in 2020/21, the first year full of the proposed changes. SGN absorb these additional costs for two years, due to the two year lag on costs, after which these will be included in the tariffs.

Figure 1



Due to the two year lag mentioned above the impact on the tariffs is not visible until 2021/22, the first year of GD2 (Figure 2). The impact on the tariffs in 2021/22 and 2022/23 is accentuated due to the two year lag and the assumed reset of allowances in GD2. For example, the £45m seen below in year 2021/22 for 0678 relates to the £31m costs in 2021/22 plus a £14m under recovery of costs from 2019/20. It is not until 2023/24 where you see a *clean* year i.e. no +/- lagged true up, resulting in tariff impacts of £32m under 0678 and £24m for 0678A.

Figure 2



What the results actually mean to the Scotland customers :-

Due to the two year lag the new methodology does no impact customer bills until 2021/22. 2020/21 has been included in the below analysis to give perspective to the increases likely to be seen under the proposed methodologies. As you can see from the below (Figure 3) an average Domestic customers bill would see significant impacts under 0678 and 0678A from 2021/22. 2021/22 and 2022/23 see steep increases due to the two year lagged true up of costs. 2023/24, the first year of the new methodology with no cost true up, sees bill of £9 (0678) and £7 (0678A) rising from £0.04 seen under the last year of LRMC (2020/21). It is not only Domestic customers that would be impacted, as you can see from Figure 4 all customer types would see significant increases. The figures show the average bill for each customer type. It is worth emphasising these are average bills, there would be significant variance in bills between each exit zone within Scotland as each has its own charge rate.

Figure 3

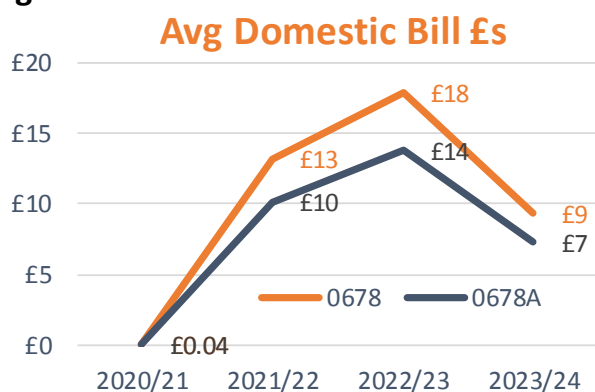


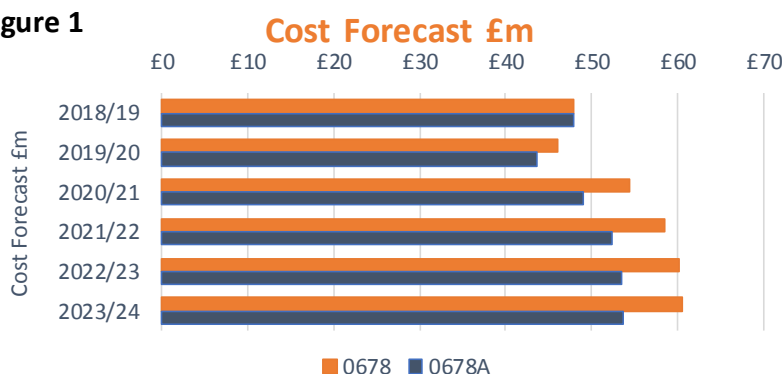
Figure 4

£'s (73.2 - 732 Kwh)	2020/21	0678	0678A
	2020/21	£1	£1
	2021/22	£179	£138
	2022/23	£242	£187
	2023/24	£126	£98
Average SOQ 1,529 (Kwh)			
£'s (> 5,861 Kwh)	2020/21	0678	0678A
	2020/21	£69	£69
	2021/22	£22,264	£17,124
	2022/23	£30,062	£23,220
	2023/24	£15,717	£12,244
Average SOQ 190,323 (Kwh)			
£'s (732 - 5,861 Kwh)	2020/21	0678	0678A
	2020/21	£4	£4
	2021/22	£1,314	£1,010
	2022/23	£1,774	£1,370
	2023/24	£927	£723
Average SOQ 11,231 (Kwh)			
£'s (Large User)	2020/21	0678	0678A
	2020/21	£548	£548
	2021/22	£175,474	£134,959
	2022/23	£237,580	£183,503
	2023/24	£123,872	£96,497
Average SOQ 1,500,000 (Kwh)			

What the results actually mean to the Southern costs:-

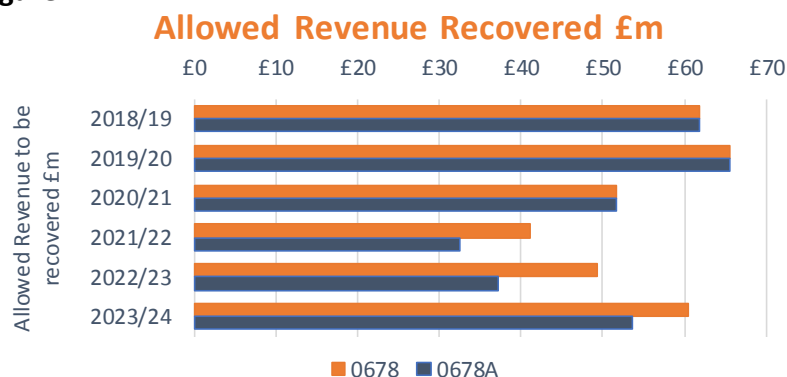
As you can see from the presentation and subsequent chart below (Figure 1) forecast costs will steadily increase under the proposed new methodologies. From £48m in 2018/19 (LRMC) to £54m (0678) and £49m (0678A) in 2020/21, the first year full of the new proposals. SGN absorb these additional costs for two years, due to the two year lag on costs, after which these will be included in the tariffs.

Figure 1



Due to the two year lag mentioned above the true impact of the new methodologies on the tariffs is not visible until 2021/22, the first year of GD2 (Figure 2). The impact on the tariffs in 2021/22 and 2022/23 sees a reduction due to the two year lag and the assumed reset of allowances in GD2. For example, the £41m seen below in year 2021/22 for 0678 relates to the costs of £59m in 2021/22 minus a £17m over recovery of costs from 2019/20. It is not until 2023/24 where you see a *clean* year i.e. no +/- lagged true up, resulting in tariff impacts of £61m under 0678 and £54m for 0678A.

Figure 2



What the results actually mean to the Southern customers :-

Due to the two year lag the new methodology does not impact customer bills until 2021/22. 2020/21 has been included in the below analysis to give perspective to the increases likely to be seen under the proposed methodologies. As you can see from the below (Figure 3) an average Domestic customers bill would see reductions until 2023/24, this is because both 2020/21 and 2021/22 includes over recovery of costs from LRMC. 2023/24, the first year of the new methodology with no cost true up, sees bill of £10 (0678) and £9 (0678A) rising from £8 seen under the last year of LRMC (2020/21). It is not only Domestic customers that would be impacted, as you can see from Figure 4 all customer types would see significant increases. The figures show the average bill for each customer type. It is worth emphasising these are average bills, there would be significant variance in bills between each exit zone within Southern as each has its own charge rate.

Figure 3

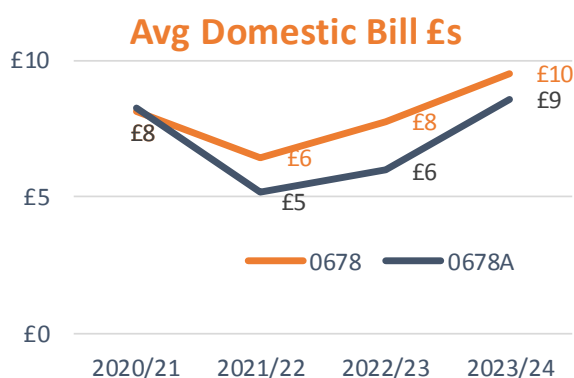


Figure 4

		0678	0678A			0678	0678A
£'s (73.2 - 732 Kwh)	2020/21	£98	£99	£'s (732 - 5,861 Kwh)	2020/21	£772	£784
	2021/22	£78	£62		2021/22	£614	£493
	2022/23	£93	£72		2022/23	£737	£566
	2023/24	£114	£103		2023/24	£906	£815
Average SOQ 1,529 (Kwh)				Average SOQ 11,231 (Kwh)			
£'s (> 5,861 Kwh)	2020/21	£9,418	£9,571	£'s (Large User)	2020/21	£92,391	£93,896
	2021/22	£7,493	£6,014		2021/22	£73,502	£58,993
	2022/23	£8,999	£6,907		2022/23	£88,526	£67,939
	2023/24	£11,050	£9,948		2023/24	£108,405	£97,592
Average SOQ 190,323 (Kwh)				Average SOQ 1,500,000 (Kwh)			

Concerns SGN have on the impacts:-

- Increase in cost will have a big impact on Scottish customers in particular. There is also the double impact in the first two years of GD2 due to the assumed reset of allowances and the two year lag true up of costs
- How substantial increases are messaged to Scottish customers. In our 0621 response we stated that we feel ...*'Ofgem has a role to play in communicating the substantial increases in costs faced by consumers and businesses.... This message will be complex given the substantial proportion of the UK gas supply being beached in Scotland'*
- Currently there is no obligation to produce a sensitivity tool for all proposals. We require clarification regarding this as we are unsure how Industry can assess the impact of the proposals if a set of prices have not been generated to enable suitable financial analysis
- National Grid, due to time restraints, will not be taking ownership of adapting their sensitivity tool for each of the alternates (unlike 0621). We would request that there are sufficient assurances in place for those alternates adapting the National Grid tool, as any inconsistencies could impact analysis
- We are also concerned by potential price volatility post implementation. There is likely to be continued volatility due to behavioural changes to bookings and the raising of counter mods from different areas of the industry
- We consider neither CWD nor Postage Stamp to be cost reflective

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
1.	What impact, if any, do you think tariff differentials between existing and new contracts will have on users booking behaviour? No comment
2.	What date should the changes proposed by the modifications become effective and why? See Implementation section on page 13
3.	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% No comment
4.	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? No comment
5.	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? No comment
6.	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. No comment