

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

Representative:	Richard Fairholme
Organisation:	Uniper
Date of Representation:	7 June 2019
Support or oppose implementation?	Oppose
Relevant Objective:	<p>c) Negative</p> <p>d) Negative</p> <p>g) Negative</p>
Relevant Charging Methodology Objective:	<p>a) Negative</p> <p>b) Negative</p> <p>c) Negative</p> <p>e) Negative</p>

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

We strongly oppose this proposal not only from a competition point of view, but also from a good governance standpoint, as it cuts across two major industry initiatives currently in progress – the NC TAR (UNC 0678) proposals and the UNC Review Group 0670. The specific concerns of the proposer could have been raised more constructively as an alternative proposal under either initiatives and progressed accordingly. Instead, we now have a Proposal which seeks to undermine good governance processes, as it pre-empts Ofgem decisions and attempts to disrupt the 0670 Review Group which is currently working towards a compliant shorthaul solution based on industry consensus.

We view this proposal as special pleading, which, if implemented may benefit the Proposer's business in the Republic of Ireland at the direct expense of many GB Shippers and consumers already engaged in the long-established shorthaul arrangements. The number of UNC 0678 consultation responses from consumers and consumer representatives supporting the continuation of shorthaul should be evidence of the important role it is currently playing in the gas market.

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

Not applicable as we oppose implementation.

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

Uniper responded to Ofgem's request for information on the impact of Vermillion's previous UNC Modification Proposal 0636 on the same subject of shorthaul. For commercial confidentiality reasons we cannot repeat that information in a UNC consultation response, but we would expect Ofgem to conduct another information request regarding this proposal. We consider this proposal to be more significant than UNC 0636 as it is seeking to remove shorthaul in its entirety, rather than amending the formula.

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

As it seeks to remove text from the UNC, it appears to deliver the intent. However, we note that the legal text was not reviewed by the UNC workgroup.

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.*

We believe the potential savings / benefits for consumers identified by the Proposer are misleading. Further details below.

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

Misleading claims about the potential benefits of implementation

The Proposer claims that implementation would benefit consumers by £146M a year. This calculation seems to be based on the incorrect assumption that Shippers currently eligible for Shorthaul are currently retaining all the optimisation benefits and not passing them through to consumers. In our view, the benefits of shorthaul are already priced to a large extent into the wholesale gas price – i.e. it may be lower today than it would otherwise be without shorthaul. Therefore, if all else is equal, removing shorthaul may be expected to increase the wholesale price of gas. We would then expect to also see an increase to the wholesale electricity price as impacted Generators may factor increased gas supply costs into less competitive bids in the electricity market. In both markets, potential commodity price increases would ultimately feed through to customer bills. It also would be reasonable to expect any wholesale gas (and electricity) price increases faced by all consumers to offset any reduction in gas transportation charges for those consumers who currently cannot avail of shorthaul.

Furthermore, those parties impacted by the complete removal of shorthaul would see both an increase in transportation costs and an increase to the wholesale price of gas (and electricity), resulting in a potential double hit. It is this kind of impact analysis which is missing primarily from the proposal, but also the Workgroup report. As a result, we would expect Ofgem to undertake a full Regulatory Impact Assessment, informed by a

Shipper information request, due to the large distributional and financial impacts of this Proposal.

We also observe that the Proposer underestimates (or ignores) the probability of actual NTS bypass which would occur if this proposal is implemented. The assertion that Users currently not availing of the shorthaul tariff would see a 25% reduction in their transportation charges is misleading and incorrect. As demonstrated through the 0678 process, there are a number of very large sites (including some consumers) who would immediately look at NTS bypass rather than pay the standard NTS transportation charges. As bypass takes effect, the NTS charging base would decrease, but the allowed revenue for NGG would remain the same, resulting in increased charges for all remaining NTS customers (including Distribution Networks and their customers). Consequently, any potential “savings” identified by the Proposer are merely temporary in nature, not permanent and therefore discounting should be applied accordingly in any analysis of the costs and impacts.

For all the reasons identified above, we firmly believe this proposal is negative when assessed against the UNC relevant objective (d) – the securing of effective competition between Shippers, Suppliers, etc.

Implementation Issues and “Adequate Notice”

It is clear that most industry participants have a different perception to the Proposer regarding “adequate notice” of changes to established charging arrangements. As has already been noted in both the 0678 Workgroup and at UNC Panel, many large industrial customers contract on multiple gas year contracts and therefore any change in October 2019 would directly impact existing contracts. Furthermore, many shorthaul-based trading contracts often span multiple years to maximise efficiency and to lock-in the benefits. We note that most contract negotiations take place during the Summer preceding the Gas Year and, in many cases, will have already been finalised. Therefore, any decision to remove shorthaul in October 2019 would force a re-opening of these contracts (if that was possible), with the resulting legal and operational costs of doing so. We would also expect the increased risk premia to be priced into future contracts.

Much of this Proposal is based on Ofgem making a decision by 31 May, which in turn has been used as justification for the phrase “adequate notice”. As this consultation is taking place in June, it is no longer, in our view, appropriate to use this term. Given the Proposer’s failed (and in our view unjustified) attempt to request Urgent status for this proposal, we are now faced with a potential notice period of less than 3 months. This is inadequate for the wholesale market to function efficiently.

In addition, we disagree with the Proposer’s assertion that: *“it will be possible to implement this Proposal for effect on the OCR tariff from October 2019 and any one of Modification 0678 (or Alternatives) for effect on other tariffs at the same time (Oct 2019) or any subsequent date.”* From our point of view, this is incorrect as many proposals include a shorthaul replacement and therefore it would be impossible to simultaneously implement a proposal that removes part of the charging arrangements and another proposal that also removes the current shorthaul (but replaces it with something else).

Due / Undue Discrimination

The proposer of 0686 argues that “Users of the current OCR receive the same service as non-Users for significantly lower charges...The service received is the transport of gas through the National Transmission System using standard capacity products with no specific restrictions about the use of these capacity products”. In the Proposer’s view this arrangement is “unduly discriminatory”, arguing that it is “primarily to the disadvantage of domestic and larger I and C customers within the Distribution Networks”.

In response, we argue that the OCR currently uses distance as a driver of costs, which influences the OCR rate available to Shippers. As such, it is clear that different consumers impose different costs on the system and therefore the costs of transporting gas is not the same for every Entry / Exit combination across all Networks.

As noted in the Competition Commission decision “An appeal under section 173 of the Energy Act 2004: E.ON UK plc and GEMA and British Gas Trading Limited”:

“the legal test for unlawful discrimination is whether relevantly similar parties are being treated differently, or whether relevantly different parties are being treated in the same way.”¹

We would argue that Users qualifying for shorthaul are relevantly different from Users who do not qualify by reason of distance or location. This is because those NTS Exit points located close to an Entry point are imposing materially less costs on the system by reason of their efficient decision to locate where they have. Therefore, in respect of the charging arrangements, treating all Network Users the same for the purposes of shorthaul eligibility could be argued to be unlawful discrimination. On this basis, it could be argued that removal of shorthaul would create, rather than remove alleged unlawful discrimination issues.

EU Compliance

It is the Proposer’s opinion that: “This proposal aims to offer the possibility to have a more compliant methodology by 31 May 2019”. In our view, this proposal offers no such solution as it is merely removing one aspect of the current charging arrangements, without objectively justifying the remaining arrangements as compliant with EU regulatory requirements. It therefore fails to offer a complete, compliant solution for the purposes of implementing NC TAR. On this basis, we consider the proposal to be negative when assessed against Charging Relevant Objective (e) – “Compliance with the Regulation and any relevant legally binding decisions of the European Commission and/or the Agency for the Co-operation of Energy Regulators”.

¹ https://assets.publishing.service.gov.uk/media/55194bf440f0b6140400036a/eon_final_decision.pdf, Para. 6.77 (underlining added for effect)