

Representation - Draft Modification Report 0541A/B

Removal of uncontrollable UNC charges at ASEPs which include sub-terminals operating on a 06:00 - 06:00 Gas Day

Responses invited by: 5pm 11 April 2016

Representative:	Marshall Hall
Organisation:	Oil & Gas UK
Date of Representation:	7 April 2016
Support or oppose implementation?	0541A - Support 0541B – Support
Alternate preference:	<i>If either 0541A or 0541B were to be implemented, which would be your preference?</i> We have a slight preference for the <i>ex ante</i> approach of 541A on grounds of simplicity.
Relevant Objective:	d) Positive g) Positive

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

UK gas terminals were not within the scope of the EU Network Codes and most chose to retain their existing 6am-6am operations when the downstream gas day changed to 5am-5am on 1 October 2015. Terminals and upstream pipeline systems were not required to change from 6am-6am and to do so would have entailed technical difficulties, considerable costs (c. £40-50m) and significant disruption. The remaining 6am-6am terminals account for about 30 bcm of annual gas deliveries of UK and Norwegian gas to the NTS. Shippers and upstream operators have done their best to mitigate the effect of operating with two different gas days at these terminals through the introduction of a scaling algorithm which preserves the integrity of claims validation arrangements. However, shippers at 6am-6am terminals now face unforeseeable and uncontrollable costs arising from daily imbalance, scheduling and capacity overrun charges. Mods 541 A and B address these unfair, inappropriate and unwarranted charges and will, if implemented, restore the level playing field for all NTS shippers which existed before 1 October 2015. The two proposed Mods ensure compliance with EU law, restore fair competition between shippers, remove the current unintended cross subsidy and preserve the commercial integrity and the liquidity of the GB wholesale market. In doing so, they will tend to favour lower gas supply costs for UK consumers.

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

We believe the implementation should be as soon as possible, not least because it is reasonably proposed that the Mod should apply retrospectively. It is important to ensure that implementation is compatible with the change to the claims validation process administered by CVSL.

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

As the upstream industry association representing UK gas producers, terminal operators and NTS shippers, Oil & Gas UK does not itself face any costs or benefits associated with implementing UNC Mod 541.

Throughout the process of implementation of the EU Network Codes designed to promote cross-border gas trade, Oil & Gas UK has sought to ensure that they do not lead to unnecessary costs or commercial risks for UK producers and shippers and that they do not damage the commercial integrity of what has been, for a long period, a well-functioning UK gas wholesale market. The scaling algorithm (Option A) was successfully introduced at 6am-6am terminals on 1 October 2015 and is working, as expected, to mitigate imbalance charges for shippers. Mod 541 continues this damage mitigation approach by providing a solution to the residual imbalance costs and charges which are not picked by the scaling algorithm.

The impact of UNC Mod 541 would be entirely positive for NTS shippers at 6am-6am terminals. Most active NTS shippers are active at 6am-6am terminals. Adoption of Option A commanded unanimous support among shippers who voted on the changes in September 2015. Implementation of Mod 541 would require some further modification of claims validation agreements and data management. The cost for shippers of such CVSL changes are expected to be modest and much smaller than those needed to implement the Option A scaling algorithm.

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

Yes

Modification Panel Members have requested that the following questions are addressed:

Q1: Respondents' views are requested on the applicability of User Pays arrangements, with supporting reasons.

In our view, the User Pays principle should not apply for two reasons: (1) the proposed Mod 541 is merely seeking to remedy the adverse consequences of implementing UNC Mod 461 to comply with the EU Network Codes and (2) Mod 541 ensures better compliance with the BAL Network Code and corrects the current misalignment of balancing incentives.

All GB industry participants were actively discussing the change of the Gas Day long before the adoption of the EU Codes or UNC Mod 461. In approving UNC Mod 461, contrary to the recommendation of the UNC Mod Panel, Ofgem was fully aware that it was

creating a situation in which there would be significant imbalance costs for GB shippers at 6am-6am terminals. In our view, EU Code compliance through UNC modifications in 2013-14 should have sought a comprehensive solution, not a partial piecemeal 'solution'. Mod 541 now offers the chance to complete such a comprehensive solution.

The current situation is not of shippers' making. Shippers are not responsible for the residual, uncontrollable charges they incur at 6am-6am terminals and they should not be required to bear the costing of restoring a level playing field in GB balancing arrangements.

Q2: Respondents' views on the six key areas of impact described in the Impact Assessment, in Section 4, of the Draft Modification Report are also invited.

Compliance with EU legislation.

The relevant EU legislation is not only the EU Balancing Network Code but also the underlying Third Energy Package Regulation EC 715/2009. We agree with the workgroup conclusion in Appendix 2 that without UNC Mod 541 neither National Grid nor NTS shippers will comply with the Balancing Network Code and Regulation EC 715/2009. At present, the charges levied by National Grid at 6am-6am terminals are discriminatory, are not cost-reflective, do not reflect genuine system needs, represent a cross-subsidy and do not act as appropriate incentives for shippers to balance. On all grounds, the GB balancing regime does not currently comply with the obligations of EU law. Implementation of UNC Mod 541 will restore the GB market and the UK to full EU legal compliance.

NTS physical needs

We contend that the proposals in UNC Mod 541 A and B would have no adverse impact on the physical needs of the NTS since they address the 'synthetic' imbalances arising from 'time-shift' volumes, not from real, physical imbalances.

Incentive to balance

Under current arrangements, the imbalance charges do not act as an effective incentive to balance. A responsible, diligent shipper at a 6am-6am terminal acting on the best available information cannot balance effectively and avoid these charges. As the workgroup report describes, shippers cannot manage or control the 'time-shift volumes' and they become aware of the mismatches long after the gas day has ended. If Mod 541 is implemented, shippers would no longer have to bear the cost of these unpredictable, uncontrollable 'time-shift imbalances' and they would have a clear and strong incentive to balance, just as shippers at 5am-5am terminals do today.

Impacts on scheduling charges and neutrality

Shippers at 6am-6am terminals are currently more exposed to scheduling charges than they were before the change in the downstream gas day. This represents an unfair source of competitive disadvantage which would be addressed by UNC Mod 541.

Since 1 October 2015, shippers at 5am-5am terminals benefit from balancing neutrality payments that result from the element of synthetic, uncontrollable charges imposed on shippers at 6am-6am terminals, as described in the workgroup report. This represents an

unfair cross-subsidy which distorts fair competition. This too would be remedied by UNC Mod 541.

Effect on competition.

The current position in which shippers at 6am-6am terminals face a significantly higher risk of imbalance, scheduling and capacity overrun charges than shippers at 5am-5am terminals has an adverse effect on competition between NTS shippers in the wholesale market. By imposing additional unmanageable risks at 6am-6am terminals, current arrangements tend to deter trading activity based on gas volumes entering the NTS at 6am-6am terminals, with a possible adverse impact on overall wholesale market liquidity. This distortion of competition and the risks to market liquidity would be effectively addressed by UNC Mod 541.

Retrospectivity

Since the Mods have been raised to address unfair charges incurred since the enforced change in the downstream Gas Day on 1 October, we believe that shippers should be entitled to reimbursement of uncontrollable charges since that date regardless of the date on which UN Mod 541 is implemented. We believe that such retrospective application is in accordance with Ofgem guidelines on the subject.

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.*

No

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

Favourable cost benefit analysis.

The provisional estimates provided for the capital and operating costs of implementing UNC Mod 541 A or B and the estimates of the benefits to shippers at 6am-6a terminals (£0.6-0.8m per annum) make implementation a highly attractive option. The quantified benefits comprise only the imbalance charges (excluding scheduling and capacity overrun charges) and are based on estimates derived during periods in 2014-16 of low volatility of daily NBP and system marginal prices. In periods of market tightness or disruption and higher price volatility, the size of the uncontrollable costs borne at 6am-6am terminals would be correspondingly higher, making the cost-benefit balance even more attractive.

Capacity overrun charges at constrained terminals.

The economic analysis has focused on imbalance charges but the potential for significant capacity overrun charges at constrained 6am-6am entry points provides an additional reason for implementing UNC Mod 541. Since the enforced splitting of the Bacton ASEP into two ASEPs in order to comply with the CAM Network Code, shippers at the Bacton UKCS ASEP now face constrained capacity in the first quarter, the peak

demand quarter, in each of the next few years. Shippers at the UKCS ASEP in these periods will therefore face a much greater risk of capacity overrun charges with few opportunities to mitigate this risk if the capacity remains sold out. Although this situation has arisen because of the unusual split of capacity at Barton, this is an issue which could in principle arise in future at other 6am-6am entry points.

Preserving the operational and commercial integrity of the UK wholesale market.

UNC Mod 541 raises fundamental questions about how the UK and the GB market should seek to implement the EU Network Codes. In some cases, they have presented an unwelcome, unnecessary and costly disruption to the well-functioning, commercial and regulatory arrangements which have served the UK market well since the mid-1990s. In our view, it is essential that UK and GB public authorities seek to mitigate the damaging unintended consequences that the EU NCs may have on shippers if they wish to preserve competition and the liquidity of the GB wholesale markets and to avert an unintended increase in wholesale gas supply costs to the detriment of UK consumers.