Representation - Draft Modification Report

UNC 0636 0636A 0636B 0636C 0636D

Updating the parameters for the NTS Optional Commodity Charge

Responses invited by: 5pm on 14 June 2018

To: enquiries@gasgovernance.co.uk

Representative:	John Costa
Organisation:	EDF Energy
Date of Representation:	14 June 2018
Support or oppose implementation?	0636 - Comments 0636A - Oppose 0363B - Oppose 0636C – Oppose 0636D - Oppose
Expression of preference:	*If either 0636, 0636A, 0636B, 0636C or 0636D were to be implemented, which would be your preference?* If a change to the Optional Commodity Charge were to be implemented from 1st October 2018 our preference would be 0636 original followed by UNC636c.
Relevant Objectives:	0636: G **g)** Positive 0636A: **g)** Negative 0636B: **g)** Negative 0636C: **g)** Negative 0636D: **g)** Negative

Relevant Charging Methodology Objectives:	0636: **a)** Positive **b)** Positive **c)** Negative **e)** Positive 0636A: **a)** Negative **b)** Negative **c)** Negative **e)** Negative 0636B: **a)** Negative **b)** Negative **c)** Negative **e)** Negative 0636C: **a)** Positive **b)** Positive **c)** Neagtive **e)** Negative 0636D: **a)** Negative **b)** Negative **c)** Negative **e)** Negative

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

EDF Energy believes that there is significant merit in updating the Optional Commodity Charge (OCC or Shorthaul) given it has never been updated since it was introduced in 1999. This, coupled with the fact that it was pegged against commodity charges instead of Capacity, has led to a distortion in its use – as commodity prices rose over the years it has become cheaper for Exit points further and further away to use it to the extent that it is now being used at distances and Exit points well beyond that which was intended, indeed as far as over 150km from one side of the country to the other. It is clear that no Shipper would invest in such a pipeline to bypass the NTS as it would make no economic sense, in addition to the fact that it would be highly unlikely to be granted planning permission to build across the country. As such the OCC has become so outdated that it is in no way representative of the avoided cost and has become an artificial discount creating unintended consequences and market distortions.

Despite a year-long fundamental review of the Shorthaul tariff by National Grid in 2015 in GDC11 and the conclusions highlighting these flaws and cross-subsidies, no change was ever proposed despite National Grid recommending the formula be updated under two proposals A & B. It is therefore disappointing it has taken this long for this charge to be updated. Implementation of this modification would therefore improve Relevant

[UNC] Objective (RO) C “discharge of the licensee’s obligations” due to the fact that National Grid has a licence obligation to keep changes up to date at all times.

For the reasons laid out above and below, we believe that the reforms set out in modification (636) could better facilitate the ROs and could lead to consumer benefit by reducing the level of cross-subsidisation by a half (£78m out of c.£145m) if these arrangements were brought in with good notice. It is not clear these benefits will be achieved though with the current modification 636 due to the planned implementation from October 2018. Market participants may well have already hedged or entered into contracts based on the current arrangements. For some customers it is possible that new prices could be factored into new contracts for October 2018 to the extent they have not been already struck but even this will be very tight.

For these reasons we don’t believe any of the modifications will further the relevant objectives on balance if implemented this October because the improvements in cost reflectivity would be undermined by the impact on competition from the short notice. Stability and predictability in charging is important in the interest of competition and consumer benefit. There may be more merit if implemented in April or October 2019 but then this will be captured by UNC621 which has Shorthaul proposals in all of the alternatives apart from UNC62D.

0636:

If any of these modifications were to be implemented in October 2018 our preference would be Vermilion’s original UNC636 modification as it meets many of the following Licencee’s and Relevant Charging Objectives (ROs)

a) Cost reflectivity - given that the formula has been updated to today’s costs of laying and operating a pipeline, it a better proxy for the use of the NTS and therefore will lead to more efficient and economic operation of the NTS/ outcomes. It also further improves Charging RO a) that compliance with the charging methodology results in charges which reflect the costs incurred by the licensee in its transportation business.

b) Neutral given it doesn’t change the fact that DNs cannot use NTS Shorthaul, but in this respect, it could currently be considered discriminatory between different NTS users.

c) Licencee’s obligations - it will improve the efficient discharge of National Grid’s licence obligation to keep its charges up to date to minimise the risk of any breach as stated. For the same reason, an updated OCC also improves Charging RO b) charging methodology properly takes account of developments in the transportation business.

d) Competition - not clear it would lead to better competition given the very short timescales for implementation.

e) GB Security of supply in the interest of consumers - by reducing this artificial discount it would disincentivise the amount of gas exported to neighbouring markets at an artificially discounted price which is being subsidised by GB consumers. Indeed it would be reasonable to assume that in raising this modification, Vermillion may well have been concerned about its ability to compete effectively with subsidised exports from GB, given the distorting effects of this outdated formula.

f) Neutral – in the Promotion of efficiency in the implementation and administration of the Code

g) And Charging RO E - there has been much discussion over whether these modifications are compliant with EU Regulations, particularly the EU Tariffs code (EU TAR). While it has been implemented, it has been made clear that EU TAR doesn't take effect until "the charging period after May 2019" and thus this means nothing is required before October 2019 in GB. UNC636 therefore does not need to reflect EU TAR, notwithstanding the fact that EU Tariffs code has no mention of any type of Optional Commodity charge and indeed gets rid of many discounts. But in terms of EU Regulations that are currently in play, this modification does comply with the EU Regulation 715/2009 which states charges should be harmonised to "*neither restrict market liquidity nor distort trade across borders of different transmission systems" (*Art.13.2) and *avoid cross-subsidies between network users, and must be reflective of costs (Art.13.1).*

0636A

This modification has some merit as it updates the formula components to reflect today's cost of steel and laying pipe however it restricts its use by applying an arbitrary distance cap of 115km which has no economic basis behind it. Therefore, while it reduces the amount of discrimination above 115km and reduces the level of cross subsidy in line with improving competition under Charging RO c it cannot be considered cost reflective and does not meet Charging RO a. However, due to the short notice for change it would be detrimental to competition.

0636B

While UNC636B updates the formula with RPI indexation it still doesn't address the size of pipe that would be built nor the distance over which it is being used and is therefore not sufficiently cost reflective and doesn't better the Charging RO a. Given it is a small improvement in the formula and the fact that the level of reduction in cross-subsidy is also very small it doesn't better facilitate competition under Charging RO c. Also, due to the short notice for change it would be detrimental to competition.

0636C

There is some significant merit in UNC636c as it supports the updating of OCC charges for non-IPs as per the original UNC636 mod and thus better facilitates Charging RO a cost reflective charges. However, due to the short notice for change it would be detrimental to competition. Also, by excluding Interconnectors from this updating of the charge it provides special treatment for Interconnection Points (IPs) without proper justification. It could therefore be considered discriminatory and thus is negative under Charging RO e as EU regulations prohibit discriminatory charges. In terms of EU TAR, it does confer some differences for IPs by removing Commodity charges from them but a) this is not needed until October 2019 and b) its about removing Commodity charges not conferring special treatment regarding a specific tariff. However, given it does reduce the amount of cross-subsidisation by using a more cost reflective method as per UNC636 we consider it is the next best modification after UNC636 which would see some benefits for consumers at some point but not from October 2018.

0636D

UNC636D updates the formula as per GDC11 option 1 it still doesn't address the size of pipe that would be built nor the distance over which it is being used and is therefore not sufficiently cost reflective and doesn't better the Charging RO a. Given it is a small improvement in the formula and the fact that the level of reduction in cross-subsidy is also very small it is unlikely to better facilitate competition under Charging RO c. It also provides special treatment for OCC at IPs by excluding IP Exit points and thus is considered discriminatory and negative under Charging RO e as EU regulations require non-discriminatory charges. Also, due to the short notice for change it would be detrimental to competition.

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

EDF Energy believes that predictability and stability of charges is important for market participants and that there should be a sufficient notice period for changes which are material such as this one. A minimum notice of 6 months should be given.

Impacts and Costs: *What analysis, development and ongoing costs would you face? Please specify which Modification any issues relate to.*

N/A

Legal Text: *Are you satisfied that the legal text will deliver the intent of the Solution? Please specify which Modification any issues relate to.*

Yes

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

N/a