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:	Adam Bates
Organisation:	South Hook Gas
Date of Representation:	14 June 2018
Support or oppose implementation?	0636 - Oppose 0636A - Oppose 0363B – Qualified Support 0636C - Oppose 0636D – Qualified Support
Expression of preference:	*If either 0636, 0636A, 0636B, 0636C or 0636D were to be implemented, which would be your preference?* Our preference is that none of the proposals are implemented, however, in the event that implementation is deemed appropriate, our "least worst" preferences are: 0636B, 636D
Relevant Objectives:	0636: **g)** None 0636A: **g)** None 0636B: **g)** None 0636C: **g)** None 0636D: **g)** None

Relevant Charging Methodology Objectives:	0636: **a)** Negative **b)** Negative **c)** Negative **e)** None 0636A: **a)** Negative **b)** Negative **c)** Negative **e)** None 0636B: **a)** None **b)** None **c)** None **e)** None 0636C: **a)** Negative **b)** Negative **c)** Negative **e)** None 0636D: **a)** None **b)** None **c)** None **e)** None

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

Introduction

We do not support implementation of any of the modifications at this time.

With the UK gas network already facing a highly changeable environment due to the approaching deadline for defining and implementing the UK charging review we view the implementation of Mod 636 as a distraction which will only increase market uncertainty. The proposed timeline for Mod 636 would add an administrative burden in the form of contractual administration, revisions to operational procedures and additional requirements for employee training simply for a temporary change and at a time where the focus should be on the long term regulatory framework for the UK Gas Network. Further given the proposed limited lead times set out in the proposals, there will be no opportunity for the market to reflect the new charges in offerings to customers. In most cases contracts will have been struck and will not allow for “price reopeners” for the upcoming Gas Year.

0636:

The proposal is unsound for a number of reasons:

- The application of the RIIO-T1 portfolio of pipeline sizes, as set out in Option 1 of GCD11 has not been tested for its suitability when used as a proxy for private pipelines. There is no evidence to suggest that routes which use OCC incorporate these pipeline diameters. This is one of the reasons why Option 1 was not pursued by National Grid, nor in its subsequent OCC methodology set out in Mod 621

- In addition to the above, the application of a broader portfolio of pipeline diameters is combined with cost assessments which are contained in RIIO-T1, but not subject to public scrutiny. There is no evidence to suggest that the costs associated with these pipelines are a reasonable proxy for the construction of private pipeline systems. Given OCC is based on the principle that it should provide a reasonably priced alternative for a system bypass, any misapplication of costs will result in inaccurate cost references and ill-informed investment decisions by customers

- The use of a M-factor based on historical flow date is flawed. Historical flows are a poor indicator of future flows, particularly where demand is likely to volatile and unpredictable (such as power generation) and to construct a transmission fee on such a variable will lead to widely differing charges (across years and across offtakes). It is erroneous to charge a single plant a different charge each year where the same pipeline infrastructure is being used. This equally applies to similar offtakes, similar distances from an entry point, but with differing flows in the previous year.

As OCC is intended to provide an indicator of costs to bypass the NTS, these costs should reflect the infrastructure put in place to support flows and as a result should be largely fixed. Ongoing annual variations in charges must mean that they are not cost reflective (costs are predominately fixed) and will prohibit customers from making economic assessments of the relative costs of using or bypassing the NTS

0636A

The imposition of what appears to be an arbitrary distance cap, based on an exclusion of fixed proportion of flows from qualifying from use of the OCC (25% by distance). Their exclusion cannot be viewed as adopting cost reflective principles as costs are not a consideration when drawing up the distance cap.

0636B

The proposal builds on Option 2 presented in GCD11 and is consistent with Mod 621, except for a distance cap. It could be viewed as sensible transition towards the likely implementation of Mod 621 (and virtually all of the alternatives), notwithstanding our general opposition to any premature and disjointed changes to the charging regime at this juncture.

The application of RPI on the underlying OCC costs is an appropriate method for scaling those cost elements which have been deemed appropriate since the inception of OCC.

Where customers have made investment decisions in the past, whether to use or bypass the NTS, the assessments were made based on a reference cost underpinned by the existing OCC formula. Given the NTS or the alternative pipeline is a fixed asset, going forward it is reasonable that the reference cost is uplifted by RPI and not, as proposed in 636 and 636C by a steel index.

0636C

We do not agree that the IPs merit individual treatment due to the EU Tariff Code. The provisions of the Tariff Code need only apply after May 2019, and in the case of GB, at the next charging setting period of October 2019. Where any provisions in the UNC do not comply with the EU Tariff Code, including any changes made as a result of the implementation of changes to OCC prior to this date, then future changes could and should be made.

Also, we do not agree that IPs should qualify based on entry and exit capacity. This is at odds with the current application of OCC and no arguments have been presented as to why an entry point should qualify as a nominated point for the purposes of identifying an OCC route.

In terms of the treatment of non-IP offtakes, the proposal mirrors the methodology changes set out in Mod 636, which as we described earlier are deeply flawed.

0636D

As set out for Mod 636C we do not agree with the special treatment of IPs, however, we note that the wider approach in relation to non-IP offtakes is consistent with Mod 636B. For this reason, we are able to provide qualified support, notwithstanding our overall opposition to the implementation of any change before Oct 2019.

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

Practically, the minimum lead time should be 6 months. This will enable the market to enter into contracts which reflect the future OCC prices and not be exposed to regulatory and commercial risks.

Certainly, implementation can only occur at the commencement of a Gas Year i.e. the earliest being 1 Oct 2018. A non 1 October date would undermine contractual arrangements and trading positions taken to optimise and minimise the costs of gas supplies to customers

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

Where notice is limited, or the date of implementation does not fall on the 1 October there would be costs related to exposures to customers, producers and/or suppliers who have entered into contractual arrangements for the upcoming Gas Year. Material changes such as those which impact OCC can only be made with sufficient lead time and at the start of a Gas Year if industry is to properly align contractual commitments and trading positions.

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.*

The Modification Report refers to a number of impacts which are not quantified, or explored in any meaningful way. These include:

Impacts on customers:

The analysis provided in the report assumes a "no change in demand" scenario in order to ascertain the broad costs and benefits to consumers. This includes any modelled re-distribution of charges across OCC and non-OCC customers, including those which move from one categorisation to another. This is highly simplistic and misleading. Further analysis must be carried out, at least at sector if not at individual customer level to understand the sensitivity of demand to change in price (elasticity of demand). It will be the case that some existing OCC customers will reduce, or discontinue demand which will result in a number of primary and secondary impacts e.g. increase the standard SO and TO commodity rates, impact power prices/competitiveness of customer in its primary market etc.

Impacts on gas supplies and GB security of supply

OCC is used extensively in the upstream market to optimise flows to customers. Where these rates are increased, it is possible that gas will be delivered to other global destinations, or at higher prices to UK customers. Proper consideration needs to be given to the costs of delivering gas from UK production fields and other importation routes compared with other European import destinations e.g. Norwegian pipeline routes to Germany and LNG regas terminals in Western and Southern Europe.

Impacts on supply contracts and beach trading

As stated above a full and proper assessment of the impacts on contracts between suppliers and customers and between producers and shippers needs to be carried out. In particular, consideration should be given to the length and the pricing structures of these contracts which may be undermined by a premature implementation of a change to OCC. In addition, beach trading could be greatly impacted by any changes to OCC and again a proper assessment of the potential to undermine any forward contracts should be undertaken.

In short, we believe that Ofgem must carry out an Impact Assessment if it is to properly assess the impacts of implementing any of these proposals. It is unable to make an informed decision on the basis of the analysis presented in the workgroup report. Certainly, the workgroup report is absent of any meaningful assessment of the impacts on customers, both domestic and non-domestic.

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

See above