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:	Henk Kreuze
Organisation:	Vermilion Energy Ireland Ltd
Date of Representation:	14 June 2018
Support or oppose implementation?	0636 – Support 0636A - Qualified Support 0636B - Qualified Support 0636C - Oppose 0636D - Oppose
Expression of preference:	0636
Relevant Objectives:	0636: **g)** Positive 0636A: **g)** Positive 0636B: **g)** Positive 0636C: **g)** Negative 0636D: **g)** Negative

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

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

0636:

- **Restores some credibility to the cost reflectivity of the OCC charge:** The OCC charge has been in existence for over 20 years and the rates which were intended to represent the underlying cost of alternative "by-pass" pipelines have not been updated since the charge was introduced. Current OCC rates do not even cover the operating costs of pipelines let alone the capital costs[1] (see Appendix 4 of workgroup report). Mod 636 is distinctly different from the alternative proposals in its use of a capacity value that is consistent with the assumed utilisation of 75%. It is unlikely that users could justify such considerable investment in a pipeline with lower utilisation. All other alternatives neglect this and thereby the resulting OCC tariffs do not reflect the actual cost per kWh of a by-pass pipeline.

[1] Appendix 3 of the workgroup report highlights that National Grid derived pipeline costs from the GCD11 formula are consistent with other published data.

National Grid Gas have estimated that the potential cross-subsidy could be up to £150m per annum. OCC flows are around 30% of total chargeable flows but only contribute 7% of total commodity revenues.

- **Reduces undue discrimination:** The current OCC rates lead to a two tier commodity charging arrangement even though all end-users are using the same transmission system. The OCC is only available to large loads (primarily connected to the NTS) and Interconnectors and is not generally available to load further downstream within the DNs, nor indeed to the DNOs acting on behalf of such loads. This is particularly relevant when considering that flows leaving GB at Interconnection Points are eligible for the OCC rate irrespective of their final downstream customer. Setting a more cost reflective charge that is just sufficient to prevent a real threat of by-pass but not so low as to be in-efficient could be considered due discrimination.

- **Reduces the risk of non-compliance:** Cost reflectivity and non-discrimination are the underlying principles of both EU 2009/715 and EC 460/2017

- **Is an important stepping stone to a longer term solution:** This proposal halves the potential cross-subsidy and allows time for further consideration of the most suitable approach for the longer-term.

- **Still retains the option of an attractive OCC:** The OCC is still an attractive option. The costs used in the charge rate are still understated as Users pay the same OCC for any amount of flow even if this is above the inferred maximum; distance is assumed to be in a straight line; there is a benefit of aggregation at Interconnectors; there is no commitment to pay a minimum level of charges and there is flexibility to opt in and out of the short-haul option.

0636A

- **Reduces discrimination for distances above 115km**

- **Does not affect discrimination nor improve cost reflectivity for distances equal to or below 115km**

- **Is a small stepping stone to a longer term solution:** It reduces the potential cross-subsidy by a quarter.

0636B

- **Partially addresses cost reflectivity:** as it uplifts the OCC charges by RPI but no account is taken of the assumed load factor and so the RPI inflated rate is still well below a cost reflective rate.

- **Does not improve discrimination:** there is minimal change to the OCC tariffs and hence minimal change to flows or eligible routes.

- **Is only a very small stepping stone to a longer term solution:** Only reduces the potential cross-subsidy by 10%

0636C

- **Proposes the same updated charge rates as 636 but only for non-IPs**
- **Seeks a special arrangement at Interconnector Points** (entry and exit) and is neither compliant with current EU legislation (EU 715/2009) nor future NC Tar legislation (EC 2017/460)
- **Is discriminatory and does not introduce fair competition**: It would effectively introduce a third tier commodity charge. Building alternative pipes will not cost any less if the input or offtake is an IP (and size of pipe is already accounted for in the formula). It is unclear why an overseas large user offtake should get cheaper transport than in GB nor why an overseas distribution network user should get ***any*** discount when a GB one gets none?

0636D

- **As 636C it seeks a special arrangement at Interconnector Points** but only at Exit. It is similarly neither compliant with current EU legislation (EU 715/2009) nor future NC Tar legislation (EC 2017/460)
- **As 636C it is also discriminatory and does not introduce fair competition**. The same detailed points apply.

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

Ideally a decision should be made as soon as possible to provide the maximum notice period for Users. National Grid's indicative charges letter for October 2018 charges have indicated that the OCC rates may change.

Users have requested October as the preferred implementation date.

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

None

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

1. What is the risk of increased by-pass?

- The following new analysis is provided in response to claims made during the workgroup development that if the OCC rates were to increase flows would simply disappear and end-users would be at risk of higher standard commodity rates than at present.

- The annual flow on the OCC is some 280,562 GWh (provided by NGG for the report) whilst the flow on standard rates is around 638,000 GWh (number from NGG charge setting report which was not specifically provided by NGG for the workgroup report). Hence the OCC flows are around 30% of total chargeable flows but only contribute 7% (£48.3m) of total commodity revenues (total commodity revenue estimated at £648.5m from NGG charge setting report Oct 2017).

- The above information has been used to estimate what percentage of current OCC flow could be discontinued (as a potential reaction to Mod 0636 rate changes) without making non-OCC Users worse off. (For simplicity it has been assumed that the same percentage reduction applies to all existing OCC flows.) The analysis shows that 66% of current OCC flow (or the equivalent of 20% of total chargeable GB and Interconnector flow) would need to cease before Non-OCC Users would be disadvantaged compared to the current situation. The proposer of Mod 0636 believes this is a highly unlikely scenario.

Before Mod 0636

	flows GWh	revenue £m	unit rates p/kWh
OCC	280,562	48.31	0.0172
standard	637,858	600.19	0.0941
total	918,420	648.5	0.0706

After Mod 0636 - no loss of flow

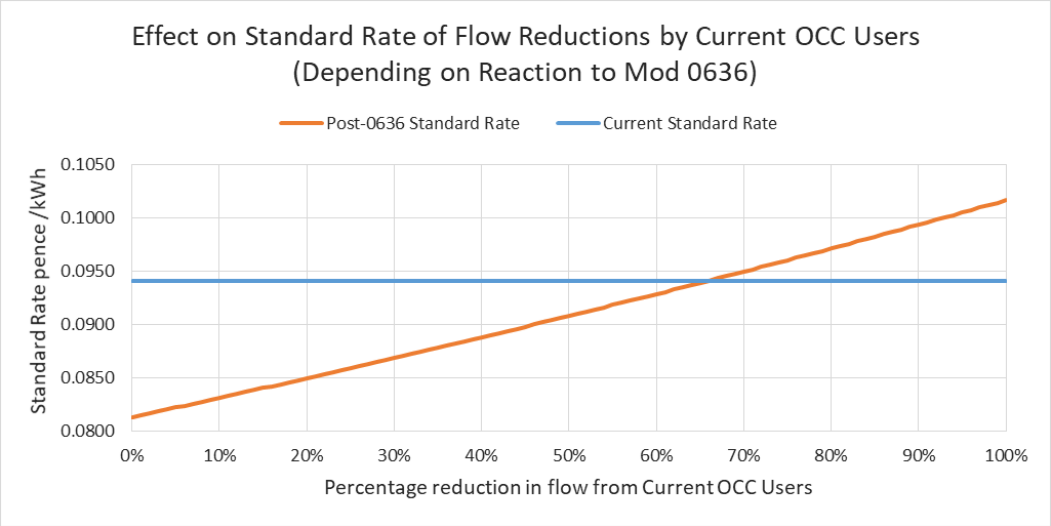
	flows GWh	revenue £m	unit rates p/kWh
OCC	187,952	54.6	0.0290
standard	730,468	593.9	0.0813
total	918,420	648.5	0.0706

After Mod 0636 where flow from Current OCC users is reduced by 66%

	flows GWh	revenue £m	unit rates p/kWh
OCC	63,904	18.564	0.0290
standard	669,346	629.936	0.0941
total	733,249	648.5	0.0884
lost flow	185,171		

Notes: (i) Unit rate for standard = combined TO and SO (entry and exit) commodity rates

(ii) Unit rates for OCC = total revenue for OCC flows/total OCC flow (ie a weighted average OCC charge)



Note: more recent NGG Charge Setting Reports (April 2018 and indicative for October 2018) show slightly lower standard commodity rates and OCC revenues but the outcome is expected to be of a similar order of magnitude. Another important point is that the allowed revenues are lower for 2018/9 than 2017/8 (hence the lower commodity figures) but the latest Maximum Allowed Revenue forecast figures just published show an increase in Allowed Revenue for 2019/20 which indicate the possibility of higher commodity charges for April 2019.

In summary there would need to be very significant reductions in flows from OCC Users before domestic and smaller I and C customers were disadvantaged.

2. Is there Discrimination in Scotland as compared to the Island of Ireland?

- Consider shippers supplying a range of domestic customers[2] with an annual load ranging between 8 and 17 MWh. In a Scottish DN they will pay Standard commodity[3] of between £7.7 and £16.30 per annum since they will be ineligible for the OCC rate. In comparison shippers supplying similar customers using the Moffat to Ireland Interconnector would pay between £1.40 and £2.90 per annum, assuming an average OCC rate of 0.0172[4]. This suggests that commodity charges to Ireland may be around 20% of commodity charges to Scotland at present[5]. In addition, since the OCC unit rate is dependent on the capacity of the exit from the NTS, differential OCC rates would be observed for a power station/very large industrial in Ireland as compared to one in Scotland (due to the large capacity of

[2]Source://www.ofgem.gov.uk/gas/retail-market/monitoring-data-and-statistics/typical-domestic-consumption-values

[3] Assuming the standard commodity rate of 0.0963p/kWh provided by NGG for the workgroup report – see page 46 of the workgroup report.

[4] This average OCC rate of 0.0172p/kWh is the current average of all OCC rates as shown in the table in 1 above using NGG data. The precise average rate for Moffat is not public knowledge.

[5] The current published standard commodity charges effective from April 2018 are 0.0838p/kWh and the latest indicative figures for October 2018 are 0.0808p/kWh

the Moffat exit point) for the same distance of short-haul route. It is hard to see how this can be considered fair competition or economic and efficient.

3. Is it economic to build by-pass pipes?

- The current OCC methodology is predicated on the costs of alternative pipelines and it is these parameters that the original Mod 0636 seeks to update in order to restore some credibility to the current charging arrangements. In this context Appendix 4 of the Workgroup report highlights that the contributions by OCC users would only cover 50% of the estimated operating costs of such pipelines (let alone the capital costs). It is hard to see how Users would be able to build much cheaper pipelines themselves and certainly no evidence has been forthcoming.

- Mod 636 is distinctly different from the alternative proposals in its use of a capacity value that is consistent with the assumed utilisation of 75%. It is unlikely that users could justify such considerable investment in a pipeline with lower utilisation. All other alternatives neglect this and thereby the resulting OCC tariffs do not reflect the actual cost per kWh of a by-pass pipeline.

4. Why Now?

- There is a significant risk that the application of the current short-haul methodology is in breach of current Licence and EU Regulations. It clearly represents an on-going subsidy for those that avail of the charge and there is no justification for this to continue unabated.

- Mod 621 is expected to address any necessary compliance issues from 2019 which notably follows the same principles of cost reflectivity and non-discrimination. More detailed work may need to be undertaken to consider whether the OCC needs further update or indeed should remain into the longer term

- The proposed 0636 updates to the charge rates would become even more important if there was any risk that Mod 621 might be subject to delay or its treatment of OCC was at risk of non-compliance with the EU Tar Code (EC 2017/460) which expects commodity charges to be a much less significant part of the ongoing charging regime. Mod 0636 would preserve any discounts at all eligible points for any remaining SO and TO Commodity charges. If there is any concern that additional discounts are necessary at IPs (due to the absence of TO commodity charges) then there is time to incorporate this prior to October 2019.

- There have been a total of 5 proposals raised since October 2017, all indicating that a change is necessary and appropriate from October 2018. This has highlighted the possibility of change to industry participants and so it is reasonable to assume that a prudent operator would have taken account of the risk of change to the OCC rates in any contracts agreed since then.

5. Other Points

- Some workgroup members have concerns that an M value that could change from year to year is a problem. It is important to note that if a by-pass pipeline were built, a lower utilisation in any particular year necessarily implies a higher unit cost to the pipeline owner. It has been suggested that a changing M value introduces unfair competition in electricity generation. Notwithstanding that Mod 0636 is not anticipated to be an enduring solution without some further refinement, it is important to see this in the context of the current situation that distorts competition in current electricity generation as some generators are eligible for (non-cost reflective) OCC rates and others not.

- The proposed charge rate increases under Mod 0636 will be very limited for short-haul routes that are genuinely short – for instance within the Bacton IP terminal.

- There have been unsubstantiated claims that there is a potential risk of some increases in electricity prices; even if this were true this is a more appropriate (ie economically efficient and equitable) outcome than domestic and I&C customers continuing to subsidise power generators via non-cost reflective gas transport charges.