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

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Organisation:	Vermilion Energy Ireland Limited
Date of Representation:	7 June 2019
Support or oppose implementation?	Support
Relevant Objective:	**c)** Positive **d)** Positive **g)** Positive
Relevant Charging Methodology Objective:	**a)** Positive **b)** Positive **c)** Positive **e)** Positive

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

Vermilion (as proposer) supports implementation of Modification 0686 for the following reasons:

Any NTS Optional Charge should be justified in relation to its compliance with the EU Tariff Code. Key principles underlying the EU Tariff Code are "the same price for the same service" and no undue discriminatory access to any special services. The existing NTS Optional Charge does not meet these criteria.

How much gas will flow through private networks if the current optional charge is removed? Some industry participants have stated this is a possibility but Vermilion has estimated that those unable to avail of the current Optional charge would only be worse off if 82% of the current flow availing of the optional rate by-passed the NTS. This seems inconceivable. There may be cases where by-pass is more likely but this should be balanced against the expected revenues such flows provide. Appendix 1[1] provides some further analysis and comment for specific cases (following analysis provided by respondents to the recent Modification 0678). In this context it is important to note that by-pass may not necessarily be a bad outcome. For instance where incremental entry is being considered a direct pipe to a nearby power station may be an economic and efficient outcome rather than more distant network reinforcement that may be required to provide wider network access (which may be underutilised). Such a dedicated pipeline would provide only a specific service and it may be possible for National Grid to mirror this by introducing a specific commercial service whilst being compliant with the EU Tariff Code. Unfortunately the continuation of current arrangements do not incentivise this.

National Grid has stated that whilst standard commodity rates would come down assuming the same flow levels, the revenue amount going through the commodity charge would stay the same. This is indeed true but as a large component of the present standard commodity charge arises from revenue under-recovery it is more consistent with Ofgem's stated aims within the Targeted Charging review for Electricity that such charges are applied to all rather than disproportionately applied to those who may in fact already be contributing more than a fair share (ie DN connected loads). Due to the 1 in 20 booking obligations DN networks book and pay for a higher proportion of NTS capacity than NTS directly connected loads which are more able to benefit from zero priced capacity products.

Is an holistic charging proposal better? This proposal furthers compliance with the Regulation (EU 715/2009) and the EU Tariff Code (EU 2017/460). UNC Modification 0678 would not be prejudiced by Modification 0686 and indeed allows time to consider more fully the necessary steps for full compliance. This may be particularly pertinent given the recent industry consultation and Modification Panel decision on Modification 0678 which has not recommended implementation of any of the 11 Alternative proposals. It may indeed prove to be the case that a fully holistic proposal is too difficult and incremental improvements to the charging methodology may be more acceptable. This 0686 Proposal may mitigate National Grid's inability to meet its Licence obligations caused by a delay to Modification 0678 by complying with the EU Tariff Code in respect of the current optional charge.

Will the changes in commodity rates be passed on to customers? It is up to individual Users how their onward charges are negotiated. There may be a lag in the system but this should not be used as an excuse to delay reform. Standard Commodity charges are already subject to change twice a year. It is hard to believe that such changes would not be passed on to end consumers in a timely manner in a competitive environment. The Optional Charge has been the subject of much industry debate over at least 4 years and so change in these rates should have been anticipated and factored into contract negotiations e.g. price formulas linked to changes in or removal of Optional Charges.

The following is an extract from the 0686 Draft Modification Report of the Proposer's justification against relevant charging objectives provided again for completeness:

[1] Appendix 1 has been included in the section headed *"Please provide below any additional analysis or information to support your representation"* at the end of this response.

Users of the current Optional Commodity Rate (OCR) receive the same service as non-Users for significantly lower charges. The average unit commodity rate for those using the OCR has been estimated at 18% of the standard commodity unit rate in gas year 17/18.This results in a cross-subsidy recently estimated at £146m per annum by sites unable to benefit from the OCR to those opting for the OCR. This cross-subsidy is primarily to the disadvantage of domestic and larger I and C customers within the Distribution Networks.

This would appear to be unduly discriminatory and anti-competitive, and furthermore has already been identified by the Authority as "non-compliant". National Grid have presented on the topic at NTSCMF meetings and did not propose to retain the OCR in Modification 0678.

Charging Relevant objective (a): Adjustments to the OCR will reduce the Standard Commodity rates (all other things being equal) and thereby reduce cross subsidies and improve the cost reflectivity of the NTS commodity charges. The existing high commodity charges have been a cause for concern for some time not least because of the upward spiral of commodity charges as more Users avail of the OCR. The high commodity rate was determined an issue in the Transition period within the Mod 621 decision. This Proposal would make a significant reduction to the existing Standard commodity charges.

Charging Relevant objective (b): Increasing take-up of the OCR over longer distances has led to a need to review the parameters within the calculation of the OCR – Modification 0636 considered such a review but the Modification was rejected by the Authority. Modification 0621 which also sought a change to the calculation of the rate was also rejected and the form of a commodity charge was deemed specifically to be non-compliant with the EU NC TAR.

Charging Relevant objective (c): As the OCR is unduly discriminatory in its application it is considered by the proposer to be anti-competitive. Its removal will better facilitate effective competition between shippers and suppliers – and specifically, it will

- *level the playing field in regard to the charges for the use of the NTS for NTS and DN connected loads*
- *and help to reduce transportation costs to domestic gas customers.*

Charging Relevant Objective (e): This proposal if implemented will further timely compliance with the EU TAR NC and EC 2009/715.

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

Vermilion has provided the following in regard to the recent consultation on Modification 0678: The new tariffs should be applicable from 1 October 2019 for compliance with the EU Tariff Code. However, should implementation by 1 October 2019 prove to be impossible and there is a delay to the introduction of new capacity tariffs the commodity elements should nevertheless be addressed in a timely manner. In particular the removal of non-compliant elements, such as the current Optional Commodity charge, should be undertaken by 1 October 2019, noting that there are different publication requirements to capacity and commodity charge elements within the EU Tariff Code. Stakeholders have already had notice that this charge would not be guaranteed through the consultations on Modification 0621 and 0636.

Ideally as much notice as possible should be provided. Nevertheless, given the requirement to be compliant with the EU Tariff Code we accept the likelihood of short notice periods.

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

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

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.*

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

Appendix 1 – Expected revenues from selected sites under the prevailing optional charge and the real risk of by-pass

In their responses to Modification 0678, several respondents provided estimates of the charges for specific sites in the event that there was no ongoing optional charge on implementation of Modification 0678. The following analysis provided by Vermilion aims to illustrate the very low charges currently payable under the present optional charge arrangement and address other relevant comments. It uses the forecast of flows for 2019/20 in the latest available FCC document/National Grid sensitivity model (v3.1).

- The following 3 power stations were referenced by SSE /Energy UK
  - Grain to Isle of Grain
  - St Fergus to Peterhead
  - Milford Haven to Pembroke

  These three power stations would contribute around £1m from the prevailing optional commodity charge.

- Easington Area

  Vermilion estimates that the current revenues from the prevailing optional charge are around £0.3m per annum from Easington to Saltend (This route has been specifically highlighted in Triton's response to Modification 0678).

  There are several industrial sites and power stations in the Easington area and some have specifically suggested they may build an alternative pipeline or join onto an already existing one. This may indeed be a sensible economic outcome for these sites. However, if a pipeline already exists and is not being used at present it highlights very clearly that the present optional charges are not high enough as they do not even cover the marginal operating costs of the existing pipelines (investment cost by implication being regarded as a sunk cost). The construction of new pipelines will take time to assess and implement and so the immediate risk of by-pass via new pipeline investment is considered to be low.

- Teesside Area

  There have been similar suggestions of a potential private network in the Teesside area. There are several sites within easy reach of the entry terminal but Vermilion estimates that 4 nearby sites would only contribute around £0.5 m in optional commodity charges under the current regime.

- IUK

  IUK have noted that short-haul facilitates cross border trade. Vermilion notes that care is needed in respect of compliance and continues to believe there should be a level playing field with the same tariff for the same service and this is particularly pertinent with regard to cross border trade. Vermilion estimates that the current revenues from the optional charge for exit at the Bacton IP are less than £0.5m per annum at present.

- BBL

  BBL have stated that they do not want a period of time without a wheeling charge. Vermilion believes that until the present interruptible reverse flow service is replaced by a firm physical service there is a negligible contribution to National Grid's allowed revenues. A wheeling charge could be considered for the future and removal of the current optional charge would focus attention on its timely development.

In summary, Vermilion believes that the current revenue recovered from the current optional commodity charge from sites that could realistically consider by-passing the NTS is very low at around £3m per annum. The risk to those who cannot currently avail of the optional commodity charge arising from by-pass therefore seems to be negligible.

National Grid are best placed to comment on this analysis and we would expect that they can share the precise details of the current revenues recovered from the optional commodity charge with Ofgem if they have not already done so.

Recent developments and 670R

National Grid has maintained that Modification 0678 is the vehicle to deliver timely compliance with the EU tariff Code. Unfortunately this looks likely to be significantly delayed. Vermilion notes that National Grid's proposal did not include a proposal for an ongoing optional charge as it was not considered to be essential and instead committed to progressing through the Modification 0670R review group if necessary. Given that the target date for implementation of Modification 678 was October 2019 (or ASAP thereafter) we assume it was acceptable to National Grid and Ofgem that there may be a period of time at least without an optional arrangement. We see no reason why work on 670R should be delayed and believe the removal of the current non-compliant arrangements will encourage efficient and timely consideration of the issues.

There has been an absence of representations from domestic consumers or their shippers in respect of the recently proposed changes in NTS transportation charges. We find this somewhat surprising. We would expect there are some shippers, suppliers or large DN connected sites who might welcome lower commodity charges.

We consider that shippers/consumers who may have been relying on the indefinite continuation of the optional commodity charge have been imprudent, especially in the light of the numerous consultations over the last 4 years.