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NTS Optional Commodity Rate – an 0621 alternative to remove it

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Our Proposal

- NTS Optional Commodity Rate is often referred to as Short Haul or the charge to Avoid Inefficient Bypass of the NTS (AIBoNTS))
- The charge attempts to act as a disincentive to large loads from laying alternative pipeline to a point upstream of the NTS.
- MOD0621 seeks to amend NTS charges within Section Y, and in doing so refine the NTS Optional Commodity Rate.
- We believe that the rate can not be justified by reference to neither the Gas Act, nor the Licence.
- We further believe the tariff distorts competition and the current proposals do not sufficiently address the underlying issues with the tariff
- Therefore our proposal removes the relevant section from Section Y as opposed to refining the product which we believe can not address all of these issues

The Gas Act

- Gas Act section 9 requires transporter to develop and maintain an efficient and economical pipeline system and subject to above comply so far as it is economical with any reasonable request to connect any premises or pipeline system
 - These requirements have always been taken to relate to transporter's network not GB systems as whole (this would include NTS, DNs and IGTs)
 - For example Economic Test for WWU does not include NTS
- Therefore, under the Gas Act there is arguably NO justification on the grounds of bypass being un-economical, as the decision should be based on the NTS system, not the GB system.

Potential Cross Subsidy

1. Between end consumer groups

- The NTS collects its allowance from its chargeable base
- The end consumer, and their needs will be different across this chargeable base, and specifically between those who attract the current optional rate and those who do not

NTS ALLOWED REVENUE (16/17) £798m+£283m=£1,081m		
	Collected through Optional Commodity	Collected through standard rates
Current	£39m	£1,042m
Assuming £160m redistribution	£199m	£882m
End Consumer	Only specific connections, including Electricity generation (to which there are more customers than connected to the gas network)	All other connections to the gas network including fuel poor and vulnerable customers

Cross subsidy*

* Assuming that the non shorthaul customers do not receive other benefits from having specific connections discounted. WWU is not aware of any example analyses to support this.

Potential Cross Subsidy Cont.

2. For services from which all customers benefit but for which only some will pay
 - The easiest example of this arises in specific costs provided in the latest price control.
 - A short haul customer will pay the same today as they did in GDPCR1
 - Therefore any incremental costs in RIOT1 will be levied solely on those customers not on short haul
 - £235.7m * was awarded in T1 for enhanced physical site security, for example. All customers benefit from this work, but only those not on the fixed Optional tariff have contributed to this cost.

*https://www.ofgem.gov.uk/sites/default/files/docs/2015/09/physical_security_decision_letter_-_september_2015_0.pdf

Summary of other issues

1. Cost reflectivity

- The tariff is not reflective of current costs or types of work that NTS carry out
- It makes no attempt to consider that different bypasses will have differing costs, using an average means that unfeasibly expensive bypass would still be eligible for the tariff even if the reality would be that bypass for them would not be commercially viable
 - Note that the Economic Test requires specific costs to be established for a new connection, such considerations could address this issue.
- As NTS **incur** no cost, it arguably can not be 'cost reflective' (as required by Standard Special Licence Condition A5) as the test is not 'would' or 'could' be incurred.

2. The tariff attempts to avoid inefficient bypass however:

- Loads may take the tariff with no intention nor ability for bypass

Summary of other issues (cont)

3. Imperfect comparison of alternatives
 - To be effective, the tariff should provide a sufficient discount so that the NPV of bypass exceeds the NPV of future revenues for the NTS (plus any assumed benefit having the connection may attract). However any load can take and leave the tariff with no long term commitment. This makes the decision a short term commercial decision between two tariffs and does not guarantee the long term avoidance of inefficient bypass

4. Protection of the Monopoly Provider of large diameter pipeline
 - The tariff does not consider any benefits that efficient new entrants could make to the overall assessment of efficient cost of the NTS under their price control

Summary of other issues (cont)

5. Any upside potential from large load avoidance
 - Large loads connected directly to adjacent entry points may increase network flexibility and free up capacity. The presence of an Interruptible option and evidence that capacity requests are not accepted in some cases are indicative that some parts of the network are constrained. Therefore in these instances bypass may benefit the network.

6. EU compliance
 - The Short haul potentially provides incentives for intra EU connections to utilise the GB system given the low cost of utilising the GB system. Should the short haul be considered as a cross subsidy this would arguably make the tariff non compliant

Potential risks from removal

1. Loss of revenue which is then levied on the remaining customers
 1. Currently customers on the short haul tariff contribute 3% of NTS revenue. This equates to c18m. However, if all loads received a standard tariff estimates suggest the proportion of revenue charged would increase to £178m.
 2. Therefore even if 50% of connections chose to bypass, the remaining consumers' proportion of NTS cost will reduce.
2. The GB market becomes less attractive, pushing up the NBP
 1. WWU has received no evidence that this would be the case.
 2. Potentially increasing a large connection's fixed cost (by owning an operating their own bypass) may help improve long term commitment and avoid stranded costs for the NTS, protecting the GB consumer

ANY QUESTIONS?

