

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:	Graham Jack
Organisation:	Centrica
Date of Representation:	13 June 2018
Support or oppose implementation?	0636 - Oppose 0636A - Oppose 0636B - Oppose 0636C - Oppose 0636D – Oppose
Expression of preference:	<i>If either 0636, 0636A, 0636B, 0636C or 0636D were to be implemented, which would be your preference?</i> None
Relevant Objectives:	0636: g) Negative 0636A: g) Negative 0636B: g) Negative 0636C: g) Negative 0636D: g) Negative

Relevant Charging Methodology Objectives:	<p>0636: a) Negative b) Negative c) Negative e) Negative</p> <p>0636A: a) Negative b) Negative c) Negative e) Negative</p> <p>0636B: a) Negative b) Negative c) Negative e) Negative</p> <p>0636C: a) Negative b) Negative c) Negative e) Negative</p> <p>0636D: a) Negative b) Negative c) Negative e) Negative</p>
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Reason for support/opposition/preference: Please summarise (in one paragraph) the key reason(s)

0636:

1. The proposal discriminates against Interconnection Points

The proposal has been presented as an “interim” solution for optional charging with an expectation that it will be superseded by solutions contained in one of the UNC Mod 0621 proposals. However, taken on its own merits (as it must be, under UNC governance procedures), the proposal provides an enduring solution. This is significant because, in this context, it fails to address the requirements of the EU tariff network code (TAR NC) that must be implemented by 31 May 2019. In particular, the TAR NC will place restrictions on the application of TO entry and exit commodity charges (for revenue recovery purposes) at Interconnection Points (IPs). This will mean that the proposed solution will result in significantly different economic outcomes depending on whether the entry or exit point in an optional charge pairing is an IP or non-IP, i.e. the solution unduly discriminates against IPs. This discrimination would take effect from 1 October 2019 when GB gas transmission charges will have to be compliant with the TAR NC.

2. If implemented, the proposal would adversely affect existing and prospective commercial agreements and consumers

Shippers strike commercial deals with other parties, including consumers, based on optional charge arrangements. These deals are typically based on gas years and therefore commence on a 1 October date. We note that proposal 0636 and the variants have a 1 October 2018 implementation date in mind. This implementation date will be problematic to commercial contracts if (as seems very probable) insufficient notice is given of tariff changes. A reasonable expectation is that notice periods should be consistent with those provided for other transportation rate changes, i.e. 150 days' notice for indicative charges and 2 months' notice for the final charges to apply. The first of these notice periods is unachievable under the current timetable for proposal 0636 and the second one might also be difficult to adhere to depending on the time Ofgem requires for their consideration. A lack of appropriate notice will give insufficient time for counterparties to assess and amend (or cancel) commercial contracts that include optional charges as part of the arrangements. This would affect negatively any consumers concerned and possibly be disruptive for the marketplace because of the significant scale of change proposed and the uncertainty it raises.

3. The proposal fails to take account of requirements of the EU Regulation 715/2009 and the EU Tariff network code.

This proposal will have an impact on gas flows across the IPs and will have implications for the trade in gas between GB and Belgium, the Netherlands and Ireland. This is because the cost of transporting gas across IPs from 1 October 2019 will materially increase because the solution does not adjust to account for there being no TO entry or exit commodity charges at IPs from that date. This means that the proposal does not address the requirements of the EU Regulation that is aimed at facilitating cross-border gas flows and it also ignores the changes to charging arrangements which are legally required by the TAR NC.¹

4. Implementation would significantly impact GB's ability to implement the TAR NC by 31 May 2019

UNC modification proposal 0621 and its 10 variants are currently out for industry consultation. The 0621 proposals seek to deliver a holistic transportation charging methodology which will result in new charging arrangements coming into effect from 1 October 2019. In developing the new methodology full account has been taken of the TAR NC and the need to be fully compliant with it by 31 May 2019. This has been a major piece of work and the solutions, when considering whether they better facilitate the code relevant objectives and the charging relevant objectives, have referred to the current charging arrangements as the baseline. If proposal 0636 were to be implemented then this significantly changes the baseline, rendering some of the

¹ GB compliance obligations and policies are not expected to change during this period, especially given (a) the government's intention to 'import' directly binding EU Regulations into UK law and (b) the Brexit transition period proposed to last until the end of 2020.

assessment made under the 0621 proposals redundant at best and misleading at worst. This would also have a negative impact on the TAR NC/ ACER consultation requirements. In our view the consequence would be a need to revisit the assessment of the 0621 solutions so that the Draft Workgroup Report could be updated to reflect industry views on how the 0621 solutions stack up against the relevant objectives when compared with the new baseline. It would be appropriate to re-consult on the updated Draft Workgroup Report so that a wider range of stakeholders are provided with an opportunity to resubmit their representations.

The timescales for delivering a new charging methodology via the 0621 proposals is already very tight – the TAR NC consultation process and the expected Impact Assessment from Ofgem significantly add to the workload, leaving little or no slack time for manoeuvre. This was brought into sharp focus by Ofgem’s direction to National Grid to have the 0621 Draft Workgroup Report ready for consultation in May 2018.

Revisiting the 0621 solutions and Draft Workgroup Report would set back the timetable by several months, even on the assumption that industry parties, including the UNC Panel, are sufficiently flexible to meet industry process requirements at short notice. The overall delivery timetable for 0621 would need to be revised as part of the work and this would need significant industry input. Also, the legal text for proposal 0621 solutions would probably need to be revised because of any changes made consequent on proposal 0636 being implemented.

We therefore conclude that implementation of proposal 0636 will have a major detrimental impact on GB’s ability to efficiently implement TAR NC on time, by 31 May 2019.

5. The proposal does not provide a methodology for inclusion in the UNC, a poor outcome from a governance perspective.

A significant shortcoming with the optional charge is that the UNC does not contain a methodology describing how the charges are derived. Making changes to the current charging basis for optional charges is therefore odd in the absence of such a methodology – arguably, many of the charging relevant objectives that refer to the current methodology cannot be properly addressed as part of this change process.

Nevertheless, the UNC should contain the methodology used to derive the charges so that industry is clear on what the rules are and are equally clear on what governance process, i.e. the UNC modification process, will be used to make future changes. Proposal 0636 does not deliver on this basic requirement and so, from a good governance perspective, it cannot be supported.

For the reasons set out in 3 above, proposal 636 fails to create a charging regime which is sustainable and enduring, given the impending need for GB compliance with TAR-NC.

6. The consumer impact assessment in the Draft Workgroup Report makes some bold assumptions

The assessment essentially assumes there will be no impact on gas flows if the proposal is implemented, i.e. that if some of the existing optional charge arrangements are no longer economic then the gas will continue to flow as previously. This is a simplistic view and it does not recognise that the optional charge helps to attract gas to the GB market, encourages trading and is important for economically sustaining major offtakes from the NTS. Therefore, if gas flows were to reduce and/ or if gas were procured from different sources because of the proposal's implementation, the perceived benefits would likely be materially impacted.

Also, since many NTS-connected gas-fired power stations rely on the optional charge, there may be consequences for the power market and the price paid by consumers for their electricity supply. Therefore, a more complete assessment of the impact on consumers is warranted and this should form part of a wider impact assessment by Ofgem.

7. The basis for establishing the peak daily offtake in the OCC formula is logically flawed

The proposal seeks to determine the peak offtake of the relevant exit point with reference to historical gas flows. This is unrealistic as it does not correlate with how actual pipelines would be sized for capacity. Furthermore, the implication is that the capacity of the pipeline would vary from year to year which is nonsensical. The result is that the optional charge tariffs would vary from year to year as the "M" value changes. So, basically, future tariffs would be dependent on historical gas flows which can, for certain offtakes, be highly variable from year to year.

In this respect, the proposal is logically flawed.

0636A

The first 6 of the issues we have raised in respect of proposal 0636 also apply to proposal 0636A.

Furthermore:

Proposal 0636A employs an arbitrary optional charge distance cap.

There is no objective justification for implementing a distance cap or for setting such a cap at 115km. Such an arbitrary restriction on the optional charge would have the effect of distorting competition in the marketplace.

Whilst we can understand that the economics of developing an NTS by-pass pipeline are likely to deteriorate with increasing pipeline length, there is no sound logic in terms of cost-reflectivity for an arbitrary cut-off as envisaged in proposal 0636A, whether at 115 km or any other specific distance. There is also at least one NTS by-pass precedent (the SEAL offshore pipeline from Elgin/Shearwater to Bacton) which is very substantially longer than 115 km.

0636B

The first 6 of the issues we have raised in respect of proposal 0636 also apply to proposal 0636B.

0636C

Issues 2 to 7 that we have raised in respect of proposal 0636 also apply to proposal 0636C.

We also note that:

Proposal 0636C seeks to discriminate in favour of IPs

Proposal 0636C does take some account of the changing legal landscape with respect to setting gas transportation charges but in doing so it wants to make a case for special treatment, if either the entry or exit point in an optional charge pairing is an IP. This would result in a dual optional charge regime that discriminates in favour of IPs. Whilst this would help to encourage cross border flows of gas, consistent with the EU Regulation, a more holistic approach to setting optional charges is preferable. The level of discrimination proposed is significant and is undue.

0636D

Issues 2 to 6 that we have raised in respect of proposal 0636 also apply to proposal 0636D.

We also note that:

Proposal 0636D seeks to discriminate in favour of IPs

Proposal 0636C does take some account of the changing legal landscape with respect to setting gas transportation charges but in doing so it wants to make a case for special treatment if the exit point in an optional charge pairing is an IP. This would result in a dual optional charge regime that discriminates in favour of IPs. Whilst this would help to encourage cross border flows of gas, consistent with the EU Regulation, a more holistic approach to setting optional charges is preferable. The level of discrimination proposed is significant and is undue.

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

Implementation should provide at least 150 days' notice of indicative transportation charges and 2 months' notice of final charges with a 1 October commencement date.

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

All proposals would require a reassessment of existing commercial contracts that include terms related to the optional charge. This would incur time and effort for commercial colleagues and legal advisors. Administration effort would also be required to ensure a timely transition to the new arrangements.

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

No comment.

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.*

None identified.

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

Given the scale of the redistribution of transportation costs likely to arise if any of these proposals were implemented, and the discrimination and legal compliance issues we have identified above, we expect Ofgem to conduct a rigorous Impact Assessment before making a final decision on whether any of these proposals should be implemented. We would like Ofgem to consider wider issues such as the possible impact on security of supply or security of price. All consumers, large as well as domestic, are likely to be impacted. Consideration should be given to the impacts on the broad spectrum of consumers in terms of both gas and electricity since the optional charge is used to support the economic supply of gas to power stations. The assessment should consider what effect the proposals will have on future gas flows. So, for example, if gas is sourced differently and if gas consumption is chocked off at some exit points, then what will be the net impact on consumers if there are consequential changes in gas market prices? As mentioned, the assessment should also explicitly consider how prices in the power sector may be affected and what this will mean for consumers.

We believe that the interaction with the 0621 modification proposals is significant and that the UNC Panel and Ofgem should carefully reflect on this before making any recommendation or decision. This should include an informed assessment of what further work would need to be undertaken to review, revise and re-consult on the Draft Workgroup Report for the 0621 proposals. The end-to-end timeline for ensuring timely implementation of the TAR NC would also need to be reviewed and revised as part of the assessment.

It is our clear view, as set out above, that none of these 5 proposals would serve the relevant objectives better than the *status quo ex ante*, taking into account the obligations of compliance with EU TAR-NC.

We remain of the view that Centrica's 0653 modification proposal is a *de facto* alternative to the 0636 proposals and that it should be assessed as part of the same Impact Assessment for the 0636 proposals.