

## 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](mailto:enquiries@gasgovernance.co.uk)

<b>Representative:</b>	Richard Fairholme
<b>Organisation:</b>	Uniper
<b>Date of Representation:</b>	14 June 2018
<b>Support or oppose implementation?</b>	0636 - Oppose 0636A - Oppose 0363B - Oppose 0636C – Oppose 0636D - Oppose
<b>Expression of preference:</b>	<i>If either 0636, 0636A, 0636B, 0636C or 0636D were to be implemented, which would be your preference?</i>  No preference – all Opposed
<b>Relevant Objectives:</b>	We do not believe any of the proposals further the relevant objectives.

<b>Relevant Charging Methodology Objectives:</b>	We do not believe any of the proposals further the relevant charging methodology objectives.
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### Reason for support/opposition/preference: Please summarise (in one paragraph) the key reason(s)

#### 0636:

One of the key aspects of this Modification Proposal is to revise the current shorthaul formula using an “M” value based on the previous year’s gas flows. The proposer argues that the shorthaul formula would, as a result, be more cost reflective. Shorthaul is designed to be an alternative to the cost of building a pipeline, but these costs do not fluctuate year to year in the same manner as gas consumption. Therefore, the resulting optional charge cannot be considered any more ‘cost reflective’ than the current formula.

Any annual fluctuation in gas consumption would also give rise to uncertainty about the following year's shorthaul rate. As noted elsewhere in this response, contracts involving shorthaul are often concluded many months ahead of the new gas year and some will cover multiple gas years. The current arrangements, on the other hand, provide an enduring rate that is known and fixed until the Shipper cancels it. This provides the required certainty for contracting purposes. Thus, we fail to see how this proposal improves on the current arrangements, in terms of market efficiency.

#### 0636A

Applying an arbitrary distance limit may limit the availability of shorthaul, but in our view, such a limit demonstrates a weakness in the underlying formula which should be self-limiting. As any distance limit for shorthaul is essentially, arbitrary, the proposal cannot be considered any more cost reflective than the current arrangements.

#### 0636B

In our view, 0636B does not properly take account of EU Regulation 2017/460 (NC TAR), which requires different arrangements at interconnection points (IPs) from 1 October 2019, on the basis that commodity charges are not allowed at IPs.

#### 0636C

See comments under 0636 in relation to M value.

#### 0636D

See comments under 0636B, in relation to EU compliance at IPs.

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

We do not consider that any of these proposals provide sufficient lead time for implementation in October 2018. Many Shippers are either currently in the midst of negotiating, or have already struck contracts involving shorthaul for Gas Year 2018-19. Assuming such contracts can be re-opened (which is far from certain), the cost of unwinding them and the disruption that this could cause would have a significant adverse impact on the gas Shipper community and many large end consumers.

For the avoidance of doubt, we completely oppose implementation of any of these proposals outside of the October-September Gas Year timing (e.g. a November 2018 implementation). This would introduce unacceptable levels of contractual risk to the market, as it is a very material change outside of the established contracting period.

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

Affected Shippers would need to consider each contract to examine the implications. If re-opening of the contract is possible, there are costs associated with unwinding trading

positions because of the contracts, which will increase inefficiency and add costs into the wholesale market, more generally.

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

The complete legal text for all Modifications was not provided before the workgroup concluded and therefore was not assessed. As a single party, we do not have the resources to analyse the full, detailed legal text.

**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**

In our view, these Modification Proposals provide little or no evidence of an increase in market efficiency, but will, if implemented have large distributional effects, reallocating costs amongst market participants. As such, these proposals could be viewed as “special pleading”.

These proposals are seeking to address a relatively small part of the overall charging regime, without fully considering the interaction with all other aspects. It has clearly been the intention of the Mod 0621 charging review that all issues should be considered in the round to ensure the impacts can be carefully understood. We would observe that trying to address a perceived market failure through a change to the shorthaul formula is little more than a “sticking plaster” and fails to address more fundamental, underlying issues. Because of the complex interactions with other aspects of the charging regime and the significant reallocation of costs amongst market participants, we firmly believe that Ofgem must now carry out a full Regulatory Impact Assessment on these proposals.

In its decision letter on National Grid’s charging proposal GCM 19 (which similarly attempted to change certain aspects of the charging regime, Ofgem (in rejecting the proposal) noted that:

*“Given the significant uncertainty around the level of change that could be brought about by this proposal, we do not have confidence that implementing this proposal would achieve the intended aims or bring about the behavioural changes that its supporters hoped for.”<sup>1</sup>*

As the benefits of these proposals are predicated on National Grid analysis, it is clear to us that these 0636 proposals present the same challenge in terms of actual vs. perceived

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<sup>1</sup> [https://www.ofgem.gov.uk/sites/default/files/docs/2010/08/gcm019\\_decision\\_signed\\_0.pdf](https://www.ofgem.gov.uk/sites/default/files/docs/2010/08/gcm019_decision_signed_0.pdf)

benefits. It is important that the purported benefits presented by the Proposers are fully tested to ensure they are realistic, genuinely achievable and more importantly, not offset by additional costs. For instance, we are concerned that the impact on UK gas and electricity consumers (in terms of increased wholesale market prices) has not been adequately addressed through the workgroup phase (although we accept that this is difficult for Shippers to perform in a workgroup setting).

In terms of gas consumers, a loss of shorthaul could be expected to increase NBP prices as it will directly impact the price complex between gas imports and exports. This could ultimately lead to less competitively priced gas coming to the UK. Furthermore, many gas-fired generators currently rely on shorthaul to help deliver competitively priced electricity in the wholesale market, thereby benefitting electricity consumers. The complete or partial loss of shorthaul benefits will expose some generators to a high TO/SO commodity charge, which will ultimately feed through into electricity wholesale market prices. Consequently, it would not be unreasonable to suggest that increases to wholesale gas and electricity prices may wipe out the purported “benefits” in terms of a reallocation of transportation costs amongst users of the network.

In terms of the overall governance process, we are concerned that industry has had limited time and resources to analyse and develop all of these proposals, given the extensive demands of Modification Proposal 0621 and the ten alternatives. Had Mod 0621 not been on the table, we believe the level of industry engagement on this important issue would have been higher and the standard of Mod development and analysis more rigorous. We note, however, that some good work has begun on the issue of shorthaul and given National Grid’s proposal to effectively end this product in the “enduring” period under Mod 0621, there is clearly a need to develop a shorthaul solution that is fit for purpose in the long-term – not just for a year or two. In our view, these proposals would be better considered as part of a more fundamental review of shorthaul, once the future UK charging arrangements are known. Until this point is reached, there is risk of implementing a change to the charging arrangements which conflicts with future arrangements, thereby necessitating further disruptive change.