Entry capacity charging

NTS-CMF 7 July 2011

Introduction

- Ofgem was asked at May 2011 NTS-CMF meeting to present 'direction of travel' for charging post GCM 19
  - Concerns expressed at meeting about the level and volatility of commodity charges
- This presentation sets out our views on issues NTS-CMF should bear in mind if developing a "new" modification
  - It does not set out solution – that is for industry to develop
  - Reviews GCM 19 as a starting point
- **Key point -** Any modification must be clear on what issues it is addressing and fully explain its merits

GCM 19 proposal

- Industry concern about the growing size and volatility of the TO commodity charge for addressing revenue shortfall

- Entry Charging Review Group formed by NGG
  - Maximise recovery of allowed revenue from entry capacity charges
  - Incentivise long term capacity bookings
  - Differentiate between entry capacity products

- Group identified several factors which caused under recovery
  - Legacy of lower capacity reserve price paid under Transcost model
  - Amount of firm capacity bought day-ahead and on the gas day
  - Profile of capacity purchase – capacity available 365 days of the year; shippers buying daily/monthly capacity does not reflect annual costs of making capacity available.

GCM19 modification proposal

- GCM19 submitted to resolve these issues
- Main proposals were:
  - Remove 33% reserve price discount for DADSEC capacity
  - Remove 100% reserve price discount for WDDSEC capacity
  - Revenue from sale of Within Day capacity treated at TO revenue
- Two associated UNC mods also submitted to facilitate these changes
  - UNC 284: remove zero price auction requirement for sales of within day capacity
  - UNC 285: restrict sale of UIOLI capacity to situations when only less than 10% of firm entry capacity is unsold

Reasons for rejection by Authority

- **Cost reflectivity** – we said the price of within day and day ahead capacity should reflect SRMC. Although SRMC not necessarily zero we did not agree that the full reserve price based on LRMC should apply.

- **Developments in the transportation business** – GCM19 reacted to volatility of commodity charge. Did not take into account:
  - the impact of entry capacity substitution on unused capacity
  - The peak level of capacity usage is lower than the amount of capacity NGG are obliged to release

- **Facilitate effective competition** – No evidence that GCM19 would reduce the volatility of commodity charges
  - GCM19 would not affect short run entry capacity constraints
  - Could also create a barrier to entry for users who want to pay more than the SRMC but less than LRMC thereby inhibiting a full allocation of available capacity
  - No evidence of undue preference under current arrangements

Way forward

- We are aware that a number of industry participants remain concerned about current arrangements.
  - Ofgem did not rule out industry developing further modifications
  - In our view it would be appropriate to consider the following:
- What is the purpose of TO entry charges?
  - To recover TO allowed revenues?
  - To reflect costs incurred in building the system?
  - To reflect costs incurred in running the system?
  - If TO entry charges reflect costs, what is the key cost driver?
- Do NGG's flow modelling assumptions produce appropriate capacity reserve prices?

Way forward

- Volatility/predictability of commodity charges
  - Shippers want more predictable and stable charges - how significant a problem is current volatility?
  - Is commodity charge volatility likely to continue into the future?
  - Will the proposal reduce volatility?
  - Should a proportion of short fall in TO entry capacity revenues be recovered through a more stable metric – a function of capacity holdings for instance?
- Cost reflectivity
  - Rejected GCM19 as day ahead and within day capacity should reflect SRMC of providing that capacity
  - Did not state that within day prices should be zero
  - Would need to ensure benefits to NTS of increasing long term capacity sales are clear
  - Is it cost reflective to charge those who have booked longer term capacity the same TO commodity charge as users who rely on short term discounted capacity? Do their charges reflect the benefit they provide to the system through booking long term? Would some form of a discount be appropriate?

Key message

- In considering changes NTS-CMF need to consider fundamental objectives of charging methodology
- Essential to identify the problem that any modification is trying to address – is it revenue recovery, cost reflectivity, charging stability, perceived unfairness of current methodology?
- Individual stakeholders can bring forward proposed modifications
- It would be appropriate for any modification to be cognisant of European legislation and EU work streams such as the gas target model
- Ofgem will continue to engage through NTS-CMF and any other transmission groups

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