

UNC Workgroup 0517 0517A 0517B Minutes
Review of the Supply Matching Merit Order in Setting Capacity Charges
Wednesday 04 March 2015
at 31 Homer Road, Solihull B91 3LT

Attendees

Les Jenkins (Chair)	(LJ)	Joint Office
Mike Berrisford (Secretary)	(HC)	Joint Office
Charles Ruffell	(CR)	RWE
Colin Williams	(CW)	National Grid NTS
Debra Hawkin	(DH)	TPA Consultants
Graham Jack*	(GJ)	British Gas
James Thomson*	(JT)	Ofgem
Jeff Chandler	(JCh)	SSE
John Costa*	(JCo)	EDF Energy
Laura Butterfield	(LB)	National Grid NTS
Nick Wye	(MW)	Waters Wye Associates
Robert Wigginton*	(RH)	Wales & West Utilities
Richard Pomroy*	(RP)	Wales and West Utilities
Thomas Dangarembizi	(TD)	National Grid NTS

* via teleconference

Copies of all papers are available at: <http://www.gasgovernance.co.uk/0517/040315>

The Workgroup Report is due to be presented at the UNC Modification Panel by 17 September 2015.

1.0 Introduction and Status Review

1.1. Minutes

LJ pointed out an inadvertent error in one of the underlined titles on page 3, namely "Entry and/or." should read as "Entry and/or Exit".¹

Thereafter, the minutes of the previous meeting were approved.

1.2. Actions

0517 0201: Wales & West Utilities (RP) and National Grid NTS (CW) to agree volumes and charges in each WWU exit zone. It was requested that Baglan Bay Power Station be used for the relevant zone.

Update: LB provided a brief overview of the presentation and explained that prices are expected to change nearer the dates of the examples.

RP advised that Wales & West Utilities are preparing their calculations for direct connects which he anticipates will illustrate the associated timings.

LJ suggested that the real question the Workgroup should be considering is 'so what' (i.e. what are the expected impacts on consumers etc.). He suggested that this would need to be considered in more detail during development of the Workgroup Report

¹ Please note: an updated version of the 09 February 2015 meeting minutes were published immediately following the meeting.

before pointing out that additional supporting evidence behind the provided figures would also be needed. **Closed**

0517 0202: *With regards to Modification 0517B* - National Grid NTS (CW) to provide a view as to whether the modification solution of average prices could be implemented into the UNC without a Licence change.

Update: CW indicated that initial thoughts suggest that a Licence change is not required as calculating charges is covered under the auspices of the Uniform Network Code, although he did acknowledge that this largely depends on Ofgem's view on the matter.

When asked, JT explained that as far as he is concerned, if National Grid NTS have sought an initial legal perspective on the matter, then he is happy for work to continue. He pointed out that Ofgem has not undertaken any legal consideration of the matter. He agreed to seek clarity from his Ofgem colleagues in due course whilst the modifications continue to progress through the process. **Carried Forward**

0517 0203: *With regards to Modification 0517B* – SSE (JCh) to articulate the scope of the modification and the rationale why.

Update: LJ explained that this would be covered in more detail under consideration of agenda item 3.0 below. **Closed**

0517 0204: *With regards to Modification 0517B* - National Grid NTS (CW) to produce data on actual prices compared to average prices for the Workgroup to see the effect of smoothing.

Update: LB provided an overview of the data provided in the two documents (Exit Prices and QSEC Entry Reserve Prices) explaining that they indicate the average (rolling) prices for parties to consider. CW pointed out that the 'Exit 2014' column displays the first year where the three year pricing average is in place.

In examining the QSEC Entry Reserve Prices, LJ suggested that the data highlights a 'gap' in the modification (0517B) as to what would happen when no historical price information is available in order to calculate prices. JCh agreed to include consideration within an amended version of 0517B in due course. **Closed**

0517 0205: *With regards to Modification 0517B* - National Grid NTS (CW) to show how commodity charges are calculated and the interaction of capacity and commodity in setting charges.

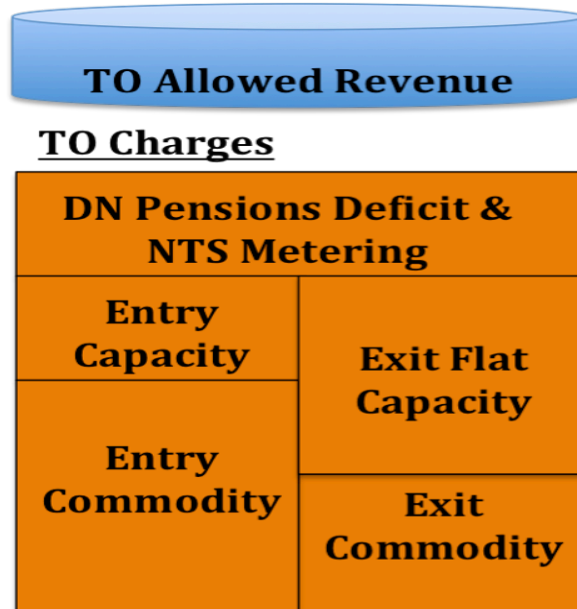
Update: CW pointed out that previous Workgroup discussions had highlighted a need to provide further clarity around how TO Commodity Charges are developed. He then provided a brief but detailed explanation behind how commodity charges are calculated in relation to capacity charges and how they interact. This is focusing on the Transmission Owner charges. At a simplified level National Grid NTS start with an Allowed Revenue for TO activities, they then net off any revenues that are to be recovered directly from certain users via specific charges, these are the DN Pension Deficit value and a relatively small NTS Metering charge. The resulting number is then split 50:50 to be the TO Entry and TO Exit revenues. For TO Entry National Grid NTS establish the amount that will be collected from auctions and the target 50% allowed revenue, less the auction revenue determines the amount to be collected from the TO Entry Commodity charge. For calculating Exit the target 50% revenue number is then entered into the Transportation Model to calculate the revenue adjusted charges. As Exit charges are based on the assumption that capacity is booked up to baseline values, in reality they are not thereby resulting in a shortfall, and in calculating this anticipated shortfall National Grid NTS has a revenue to collect from the TO Exit Commodity charge. This is shown in the diagram below to highlight how the charges are calculated. It can therefore be understood that as commodity charges are there to recover any anticipated amount not collected from the capacity auctions/charges to achieve the target revenues, then they will naturally be impacted as a result of changing Entry reserve and Exit Capacity charges. (i.e. if capacity

charges go down as a result of averaging then commodity charges would increase, and should capacity charges increase as a result of averaging then commodity charges would reduce).

Example

Key considerations:

- Effective 50:50 split between Entry and Exit Charges
- Capacity charges currently do not achieve the target revenue, requiring a commodity charge to act as the balancing charge to recover the required target revenue.



Referring to the Exit Prices presentation from action 0517 0204, CW explained how price ‘swings’ work in practise. When asked, he indicated that, as prices never actually catch up with reality, National Grid NTS have to make a ‘best guess assessment’. DH explained that it is really the throughput effects that are difficult to accurately assess. LJ suggested that this matter would need to be clarified better within the Workgroup Report. When asked, CW confirmed that there would/could be some material MSEC related impacts.

In considering how best to articulate the interaction between capacity and commodity in setting charges within the Workgroup Report, one suggestion put forward is to look at prices set at a given point in time and look to highlight the cumulative effect on recovery of commodity aspects. LJ wondered whether this highlights any potential competitive market related issues, to which NW suggested that in terms of National Grid NTS’s licence (relevant) objectives, he does not think the current proposal (0517) provides a cost reflective solution.

Whilst DH did not believe that this has a material effect on allowed revenue collection via the charges, CW pointed out that the crux of the matter relates to striking a balance between the two charging pools (i.e. commodity / capacity) - NW pointed out that we are only looking at two years of information, whilst JCh suggested that this highlights a possible TO Commodity Charge shift.

CW and JCh agreed to discuss the matter offline and thereafter look to provide examples of how the commodity / capacity charge aspects would work, in time for consideration at the next meeting. **Closed**

2.0 Further consideration of the key issues arising from 0517B

LJ suggested, and parties agreed, that the bulk of discussions had already been covered under consideration of the various actions under item 1.2 above, and that information provided by JCh prior to the meeting had now been incorporated within the draft Workgroup Report (ref: the volatility statement on page 11) being considered under item 3.0 below.

3.0 Development of Workgroup Report

Focusing on 'Section 4 – Relevant Objectives', LJ explained how the Proposers (of 0517, 0517A and 0517B) views would be reflected (each being colour coded), and challenged by the Workgroup members within this section.

Looking at the 'Workgroup Assessment' aspects, some parties believe that these are more theoretical statements, due in part, to the fact that charging is a unique exercise and that perhaps it would be better to assess each modification independently. Some parties questioned whether such an approach would actually add value.

In considering how the Workgroup would/could be expected to define 'cost reflectivity' and thereafter assess whether an impact has a positive (or negative) effect on a relevant objective, LJ outlined how the Workgroup would need to address assessing any relevant objective(s). In short, stating that a relevant objective receives a positive effect means that under normal circumstances, the Solution is better than previous provisions (i.e. an net improvement). He also explained that in instances where it is deemed that a Solution has a 'neutral' effect on a particular relevant objective, it normally means it maintains the 'status quo'. At the opposite end of the scale, a negative impact would infer some form of deterioration.

LJ highlighted that more information, demonstrating potential benefits (not just the how, but also the why aspects), would be needed before the Workgroup could comfortably complete this section of the Workgroup Report. CW suggested that it might be possible to have a single (group) statement appertaining to the first three relevant objectives, and differing statements for the remaining objectives. LJ requested that the Proposers consider providing supporting commentary behind their respective statements, although both RP and LB argued that there was already sufficient information provided in support of their respective modifications (0517 and 0517A).

NW suggested that the real impact for Shippers and Customers relates to how the modifications potentially impact upon their charges/prices (i.e. split out the theoretical from the practical aspects/effects), as he believes that the Workgroup would need time to assess potential impacts, especially the Exit area – possibly look to adoption of a 1st/2nd order principles style approach.

When asked, JCh agreed to provide a supporting narrative for modification 0517B and especially around the 'step change' impacts and utilisation of rolling averages, in time for consideration at the next meeting. He also indicated that it is SSE's intention that 0517B should be an enduring solution, even though there is only two years worth of data. In response to a question on whether the industry would expect to review the priority lists again (i.e. in two years time for instance), JCh indicated that he would consider providing more information around the stability and smoothing benefits v's volatility aspects within an amended version of his modification (0517B) in due course.

Whilst CW suggested that the cost reflectivity aspects of 0517B need further enhancement, LJ also suggested that the various potential cost reflectivity impacts would need to be included within the Workgroup Report in due course. In briefly considering Ofgem's future Gas Transmission Charging Review, NW suggested that this would be unlikely to dampen any potential cost reflectivity aspects and felt that the last sentence should be removed. Responding, CW pointed out that this was not the final Ofgem model. JT advised that any concerns relating to Ofgem's future position on this initiative are not a UNC related matter and comments should be provided via the formal consultation route.

Moving on to consider 'Section 5 – Implementation', LB provided a brief explanation in support of the recent changes to the timetables, which are now reflected in this latest

iteration of the draft Workgroup Report (v0.2, dated 04 March 2015). LJ suggested that an amended 0517 modification might be required in due course to align with the Workgroup Report.

In focusing on table two on page 13, CW advised that in his view this does not alleviate some of the 0517A concerns because the potential impacts surrounding the application window (i.e. 2years) still apply. LJ suggested that additional columns for both 0517A and 0517B should be included to aid clarity.

New Action 0517 0301: *Modification 0517A - National Grid NTS (LB) & Wales & West Utilities (RP) to look to provide similar information to that provided by National Grid NTS for inclusion in a revised set of timeline tables.*

In summing up progress, LJ advised that enhanced explanations (within the WGR) around potential impacts, especially in the area of the relevant objectives would be needed whilst he is also looking to Shipper representatives to challenge any statements. However, he reminded those present that it is not necessary to get 100% agreement as the report seeks to highlight all views.

In considering the options for how to potentially deal with a new location (Canonbie Entry Point for example) where there was not sufficient pricing history to enable a three year average to be calculated, CW suggested that possibly two options could be considered which were to either use the prices of a nearby location where there was insufficient history for the average to be calculated thereby enabling the use of average for new location, or to use as many years as was available (i.e. the first year would be based on one year, the second based on an average of two years, then the third year would be the average as per other points). A further suggestion was to adopt a form of back calculation (although it was acknowledged that this option potentially introduces issues around different treatments of Entry/Exit Points). Another suggestion was to identify the nearest couple of Entry Points to Canonbie and average these out. CW suggested that regardless of which option was adopted, flow related impacts would also need consideration.

When asked how User Commitment for Exit would be set under the provisions of 0517, CW advised that it is on a best estimate at any given time basis. DH supplemented this by explaining that it is based on prevailing charges (four years worth of capacity charges). Responding, NW suggested that perhaps the industry could look to utilise indicative prices to set these, although he recognises that the modification would need to include how these could/would work. CW suggested that recalculation of indicative prices would be needed and felt that using a 'nearest location point' approach highlights concerns around how the models work in terms of including volume and flow related impacts. When asked how the User Commitment would be set up under 0517B, CW advised that the Gemini prices would be used as the new average prices. However, he pointed out that for any new site (i.e. introduces new capacity), this is a weak solution.

LJ suggested that JCh would need to include consideration of User Commitment aspects within an amended 0517B whilst also deciding on which of the possible options to use. Additionally, JCh would need to explain how years 2, 3 and 4 are calculated in terms of User Commitment aspects – CW suggested that JCh could either take the model price as equalling the User Commitment, or calculate average prices based around adjacent sites. LJ pointed out that in short, JCh would need to amend 0517B to identify the impacts behind smoothing and User Commitment aspects.

GJ enquired as to whether or not the National Grid NTS calculated average prices are based on the longer term average prices - in essence, asking when do we stop using average to calculate future charges (i.e. when does the effect of the average indicative prices get superseded by the average of the actual prices). He also wondered whether we could extrapolate for indicative charges purposes. Responding, CW warned that care was needed around potential impacts of using average, averages. At this point, GJ suggested that the average should always be based on the underlying prices. LJ pointed out that it is only when you get to year four that you encounter actual prices and it is how you calculate

charges for new sites that is crucial. Again this is something that JCh would need to consider as part of amending 0517B.

CW also suggested that for 0517B purposes consideration of how we calculate the incremental (Entry) step price changes is needed, especially any implementation related impacts.

RP wondered whether the possible 0517B impacts around averaging and residual effects on commodity prices, could be both positive and negative in nature. LJ doubted that this would result in any negative commodity charges in reality.

New Action 0517 0302: *Modification 0517B - National Grid NTS (CW) to look to support SSE (JCh) in amending Modification 0517B to align with Workgroup discussion points, in time for consideration of an amended modification at the 01 April 2015 meeting.*

4.0 Next Steps

LJ outlined the basic agenda items for the 01 April meeting as follows:

- Consideration of amended modification(s);
- Consideration of enhanced information (WWU's timeline information) for inclusion within the Workgroup Report – *circa 30 minute review*;
- Consideration of the Workgroup Report Relevant Objectives statements, and
- Consideration of Legal Text.

5.0 Diary Planning

Further details of planned meetings are available at: www.gasgovernance.co.uk/Diary

Workgroup meetings will take place as follows:

Time / Date	Venue	Workgroup Programme
10:30 Wednesday 01 April 2015	31 Homer Road, Solihull B91 3LT	Workgroup 0517: Development of Workgroup Report (<i>inc. consideration of any amended modification requirements, enhanced timeline and relevant objectives information</i>). Consideration of Legal Text.
10:30 Wednesday 06 May 2015	Elexon, 4th Floor, 350 Euston Road, London, NW1 3AW	NTSCMF and Development of Workgroup Report 0517
10:30 Wednesday 03 June 2015	31 Homer Road, Solihull B91 3LT	Workgroup 0517: Development of Workgroup Report

Action Table

Action Ref	Meeting Date	Minute Ref	Action	Owner	Status Update
0517 0201	10/02/15	1.2	WWU and National Grid NTS to agree volumes and charges in each WWU exit zone. It was requested that Baglan Bay Power Station be used for the relevant zone.	Wales & West Utilities (RP) and National Grid NTS (CW)	Update provided. Closed
0517 0202	10/02/15	2.1	<i>Modification 0517B</i> - National Grid NTS to provide a view as to whether the modification solution of average prices could be implemented into the UNC without a Licence change.	National Grid NTS (CW)	Carried Forward
0517 0203	10/02/15	2.1	<i>Modification 0517B</i> - SSE to articulate the scope of the modification and the rationale why.	SSE (JCh)	Update provided. Closed
0517 0204	10/02/15	2.1	<i>Modification 0517B</i> - National Grid NTS to produce data on actual prices compared to average prices for the Workgroup to see the effect of smoothing.	National Grid NTS (CW)	Update provided. Closed
0517 0205	10/02/15	2.1	<i>Modification 0517B</i> - National Grid to show how commodity charges are calculated and the interaction of capacity and commodity in setting charges.	National Grid NTS (CW)	Update provided. Closed
0517 0301	04/03/15	3.0	<i>Modification 0517A</i> - National Grid NTS (LB) & Wales & West Utilities (RP) to look to provide similar information to that provided by National Grid NTS for inclusion in a revised set of timeline tables.	National Grid NTS (LB) & WWU (RP)	Pending
0517 0302	04/03/15	3.0	<i>Modification 0517B</i> - National Grid NTS (CW) to look to support SSE (JCh) in amending <i>Modification 0517B</i> to align with Workgroup discussion points, in time for consideration of an amended modification at the 01 April 2015 meeting.	National Grid NTS (CW)	Pending