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# Pricing Volatility

NTSCMF - 20th July 2012

## Agenda

- Background
  - Focus on Exit
- Interaction of revenues and charges
- The causes of pricing volatility
- Potential Way forward

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# Why we are talking about price volatility

- We recognise price volatility is a concern for stakeholders
- Feedback has highlighted:
  - dissatisfaction with volatility in Exit charges
  - an understanding that changes in allowed revenue drive charge changes
- Changes in allowed revenues:
  - TPCR4 – Rollover for 2012/13
  - New RIIO-T1 for Gas Transmission for 2013/14 to 2020/21

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# Background - Stakeholder charging concerns

## Predictability

Reliability of National Grid charging forecasts

## Transparency

Information availability for customers including reasons for change to make informed charging forecasts

## Stability

Knowing level of change to charges over time

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# Background - Who pays each charge?

**<u>Non-Storage Entry</u>**

**TO Entry Capacity (Auctions)***

**SO Commodity**

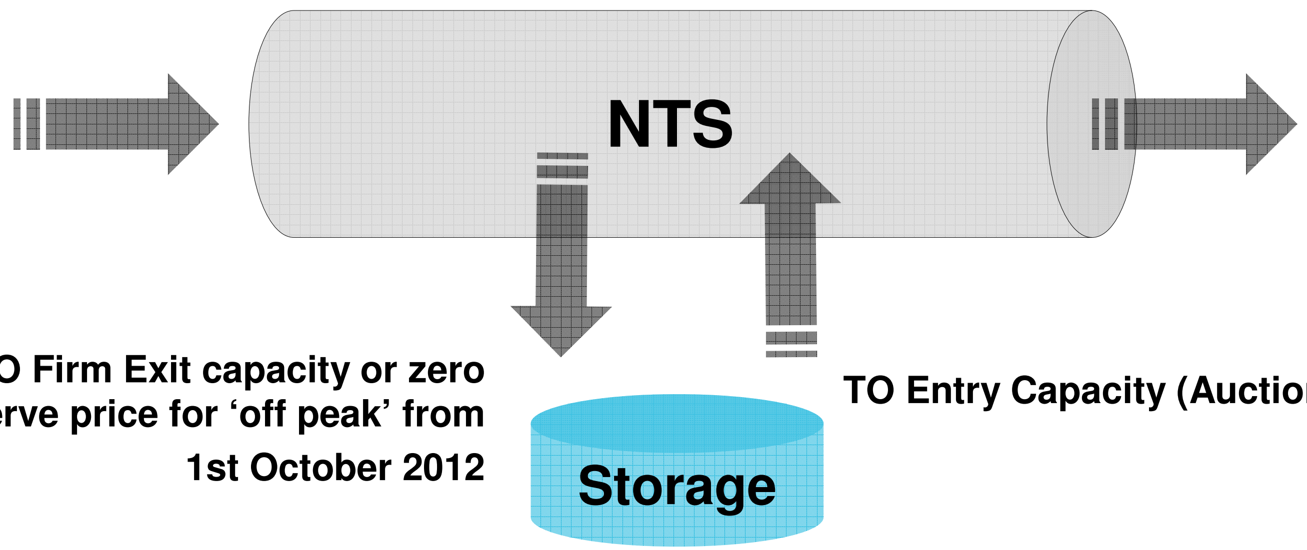
**TO Entry Commodity**

**<u>Non-Storage Exit</u>**

**TO Exit Capacity (Firm)* or zero reserve price for ‘off peak’ from 1st October 2012**

**SO Commodity**

***(TO Exit Commodity from 1st October 2012)***




**TO Firm Exit capacity or zero reserve price for ‘off peak’ from 1st October 2012**

**TO Entry Capacity (Auctions)***

****Currently SO if Incremental capacity – above obligated level. In RIIO-T1 period this is proposed to be TO.***

Entry and Exit Commodity charges are NOT applied at storage sites except for ‘own use gas’. Commoditised costs are only recovered from ‘new’ gas entering the system and from gas that permanently leaves the system to avoid double counting.

# Background - Which charges are we talking about?

- NTS TO Capacity and Commodity Charges (~ £656m forecast target for 2012/13 - £320m Exit and £336m Entry)
  - Recover transmission owner (TO) investment costs, ownership and maintenance
  - p/kWh/day entry reserve prices set annually ex ante for capacity for years y+1 to y +16
  - p/kWh/day exit prices set annually ex-ante

- Transmission Charges
  - Maximum Allowed Revenue (MAR) has been set via a price control and has RPI applied on a yearly basis.
  - Charging Methodology (requirement of licence, part of UNC) states that we must aim to recover TO MAR via a 50/50 split between Entry and Exit Charges (after MAR deductions of DN Pensions and NTS Metering charges)

# NTS Transportation Charges & Allowed Revenue (from October 2012)

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- Firm Exit (Flat Capacity) charges adjusted to recover target allowed revenue from baseline capacity
- Revenue associated with unsold baseline recovered from TO Exit Commodity

**TO Allowed Revenue**

**TO Charges**

**DN Pensions Deficit & NTS Metering**

**Entry Capacity**

**Entry Commodity (when a revenue shortfall from capacity auctions is forecast)**

**Exit Flat Capacity**

**Exit Commodity from Oct 2012**

SO Allowed Revenue

SO Charges

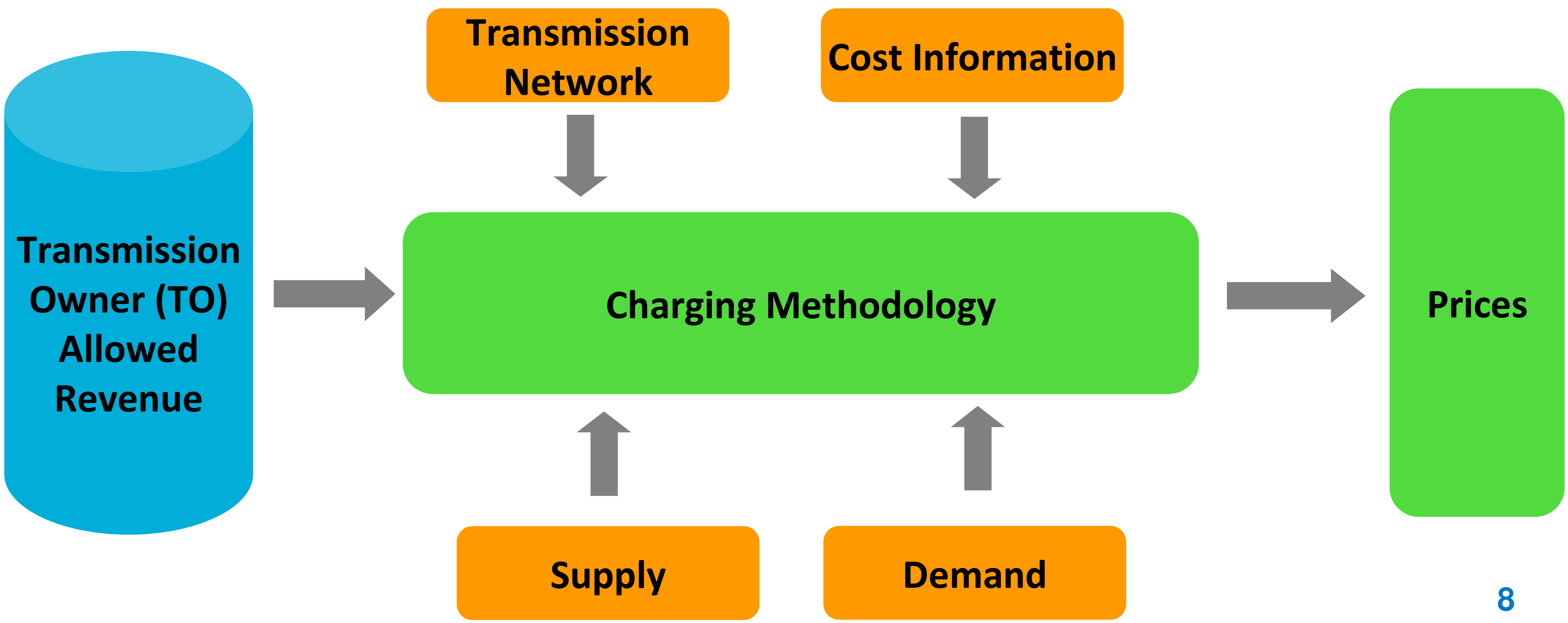
St Fergus Compression + Short-haul + Incremental Entry/Exit + On-the-day Entry + Neutrality

Entry Commodity

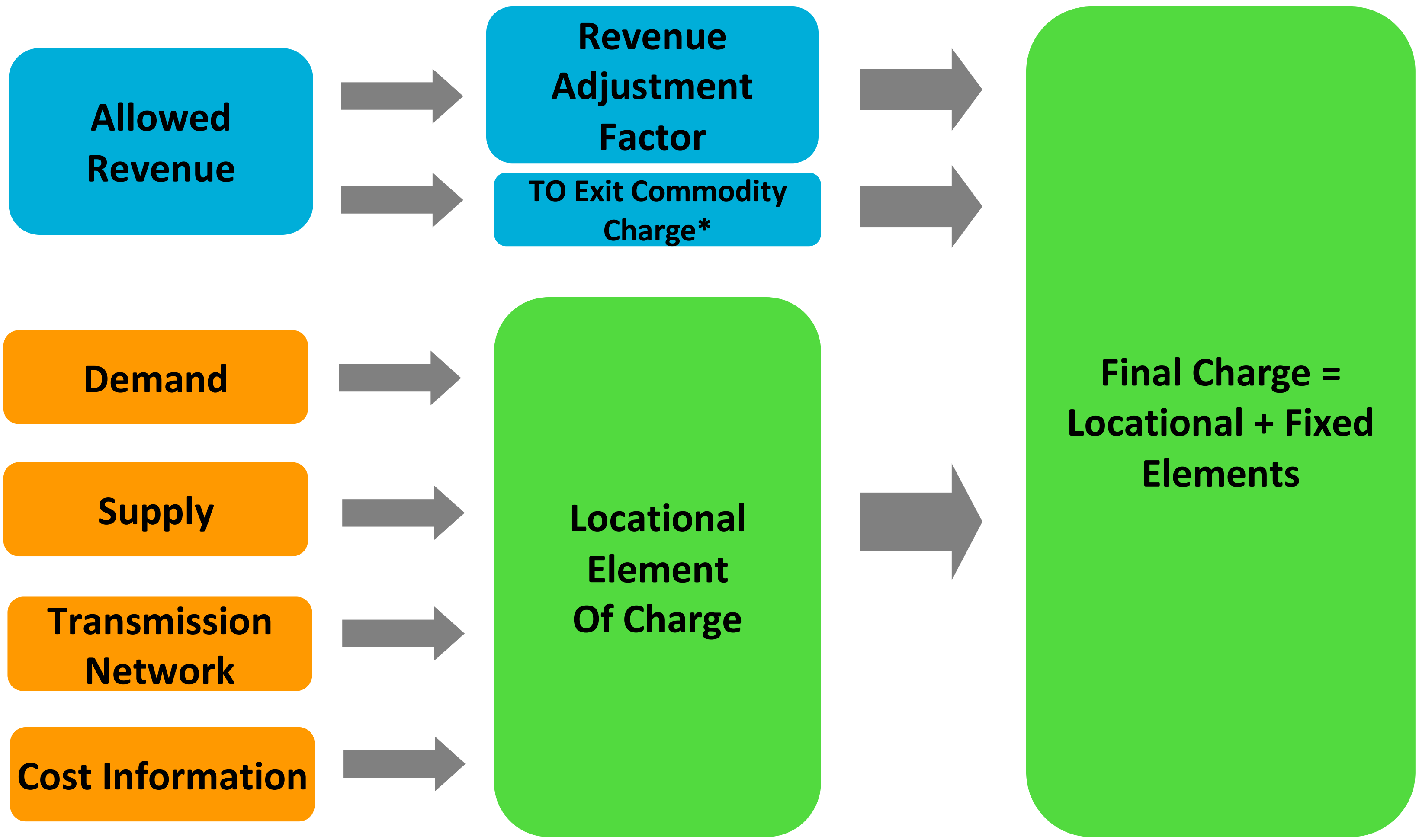
Exit Commodity

# TO Charges and influences

- Changes to tariffs can be caused through:
  - Changes in the inputs to the methodology
  - Changes to the actual methodology
  - New Products



# Impact of changes to charging inputs on TO Exit Capacity Charges




*TO Exit Commodity effective from 1st October 2012

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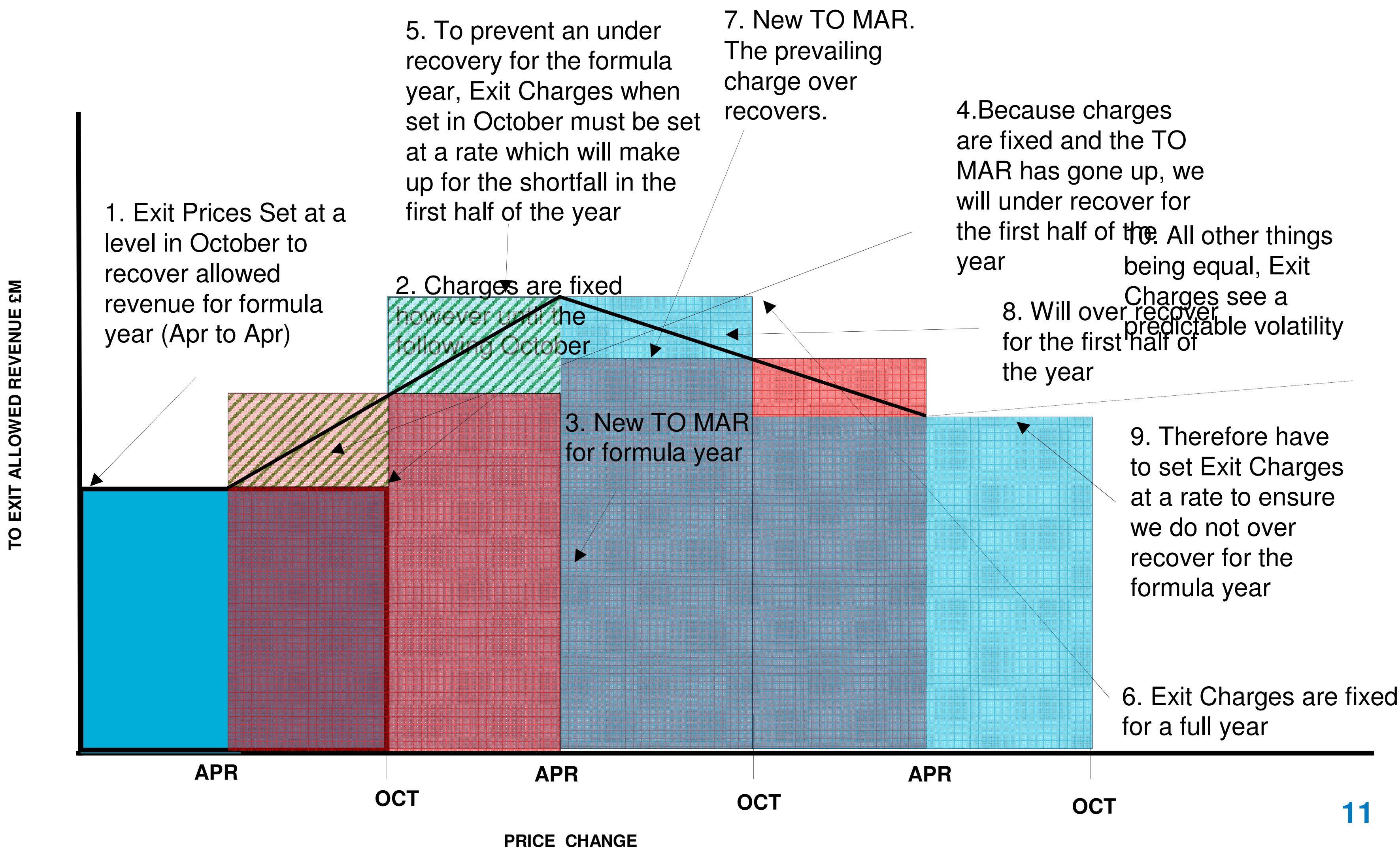
# Background to TO Exit Charge Setting

- Principal formula in Licence requires NGG not to over recover and charges are set to align Allowed and Actual Revenues
- Exit charges are set for $Oct_t$ to $Sep_{t+1}$ (Gas Year)
- TO MAR applies for $Apr_t$ to $Mar_t$ (formula year t)
- Charges set in October at a level to recover remaining TO MAR for current formula year
- Taking into account revenue already recovered $Apr_t$ to $Oct_t$, and to be recovered for the final 6 months of the formula year
- Not looking forward to following years Allowed Revenue
- Exit charges have been set at a rate to recover remaining TO MAR for the previous $Oct_t$ to $Mar_{t+1}$ but TO MAR changes in $Apr_{t+1}$
- This will cause changes in Exit Charges as illustrated on the next slide

# Setting Exit Capacity charges



# Using October 2012 Exit Charge Notice - Example

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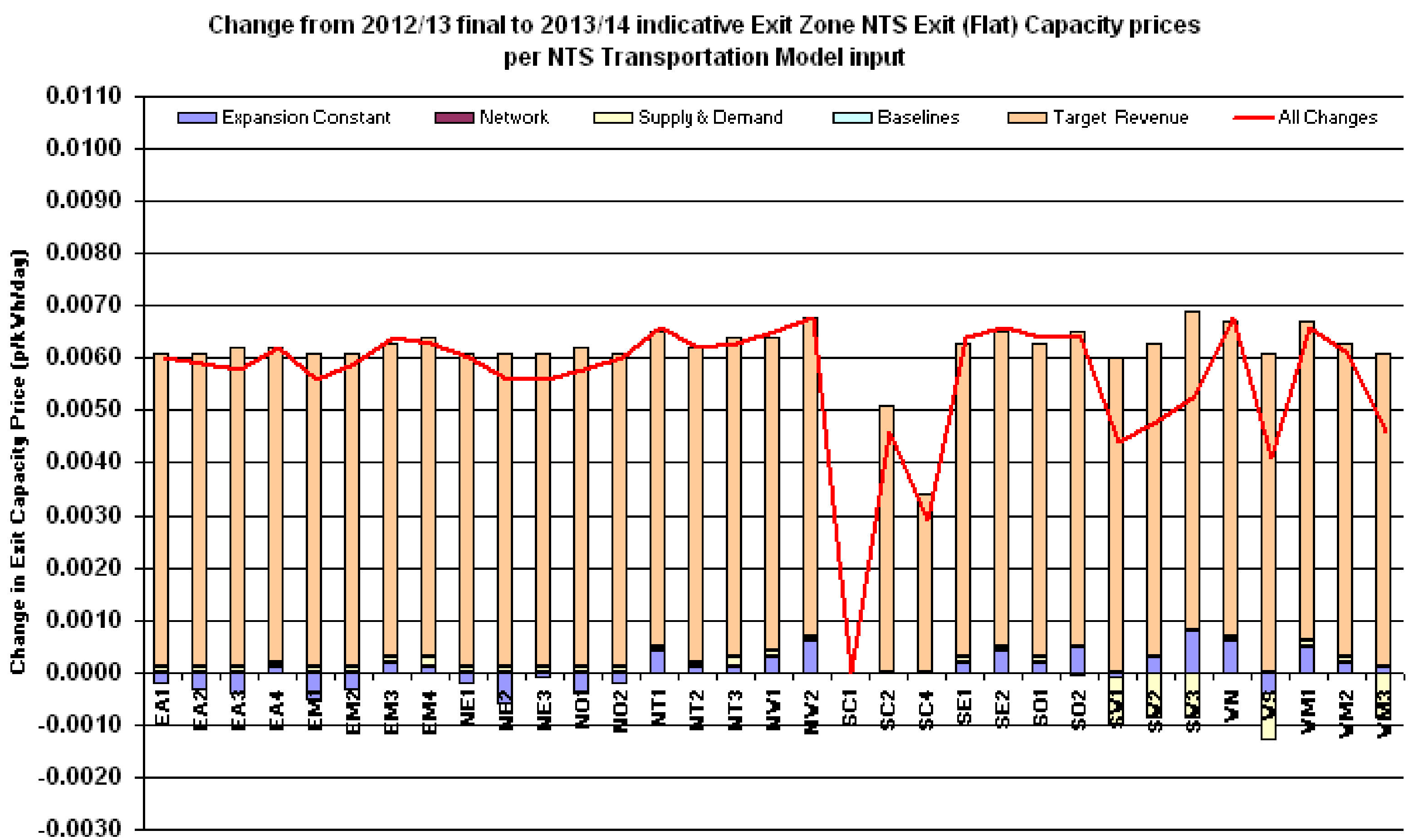
| NGG TO | 2011/12 | 2012/13 | 2013/14 | 2014/15 | 2015/16 |
|---|---|---|---|---|---|
| | £m | £m | £m | £m | £m |
| Initial Revenue to be collected via Exit charges | 288.2 | 319.7 | 432.5 | 428.3 | 465.7 |
| minus charges foregone | 80.6 | 38.5 | - | - | - |
| **Revenue to be collected via Exit charges** | **207.6** | **281.2** | **432.5** | **428.3** | **465.7** |
| Collection in first half of the year | 97.4 | 110.2 | 171.0 | 261.5 | 166.9 |
| Collection required in second half of the year | 110.2 | 171.0 | 261.5 | 166.9 | 298.9 |
| **Annual figure for charge setting** | **220.5** | **342.0** | **523.0** | **333.7** | **597.7** |

- Oct 11, TO Exit charges set on £220.5m.
- April 12, new TO MAR Exit target of £281.2m. Under application of the methodology, no charge change until Oct 12. Licence states change once per year for TO Exit Charges in Oct.
- Oct 12, based on recovery to date of £110.2m, shortfall of £171.0m must be recovered from Oct12 to Mar13. Charges set to recover this based on £342m.
- Apr13 to Sep13, also recover £171.0m as charges set from Oct12 to Sep13

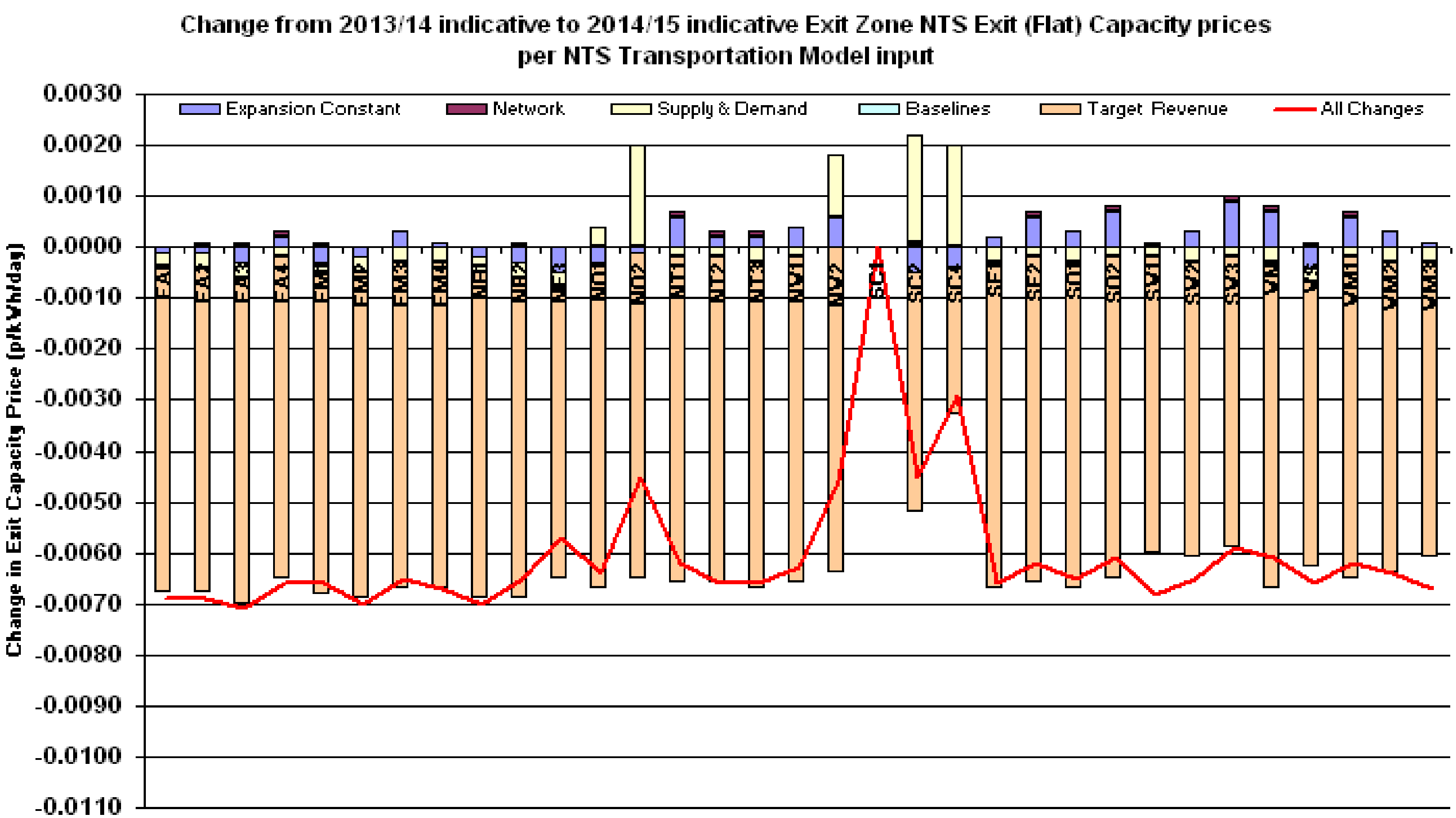
## TO Exit Capacity Prices – Causes of changes

- On 1st May 2012 Final Charges were sent for TO Exit Charges for 12/13 along with indicatives for 13/14, 14/15 and 15/16
- There were some notable changes in the prices between years
  - The contributory elements that have changed are:
    - TO Allowed Revenue
    - Expansion Constant
    - Supply / Demand flows
    - Network
- The impacts of these changes by Exit Zone for 2012/13 to 2015/16 is shown in the following slides

# TO Exit Capacity Prices
# Final 2012/13 to Indicative 2013/14

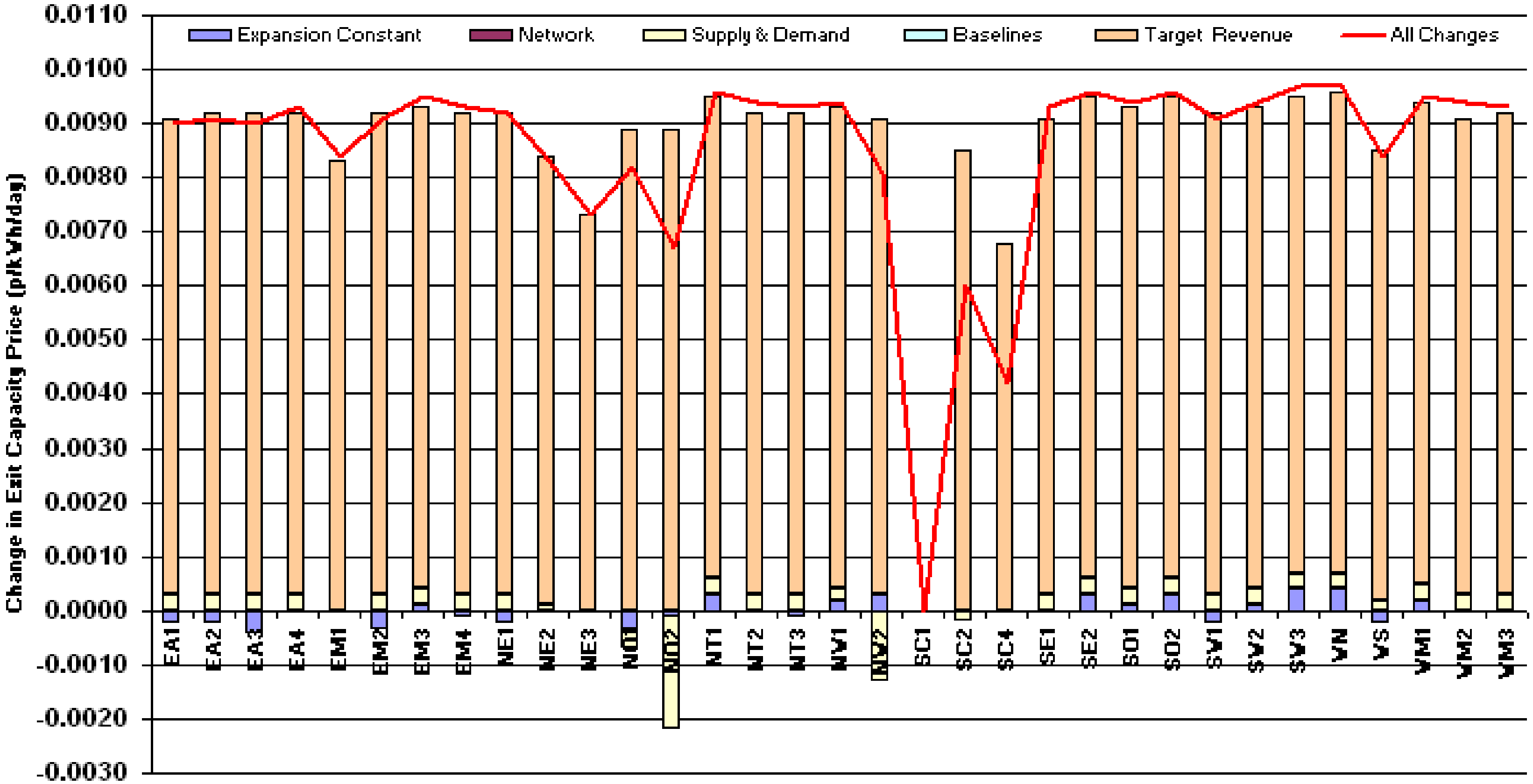


# TO Exit Capacity Prices
# Indicative 2013/14 to Indicative 2014/15



# TO Exit Capacity Prices
# Indicative 2014/15 to Indicative 2015/16

Change from 2014/15 indicative to 2015/16 indicative Exit Zone NTS Exit (Flat) Capacity prices per NTS Transportation Model input



## Summary for Exit Capacity Charge volatility

<u>Key Reasons</u>

- In respect of TO Exit (Flat) capacity
  - Allowed Revenue Changes drive revenue adjustment factor to ensure correct recovery of all baseline capacity sold
  - As a result NGG set charges to collect target revenues within the year

<u>Other Reasons</u>

  - Supply / Demand levels – changes in flow patterns

# TPCR4 / RIIO-T1 – Impacts on Charge Changes

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Allowed Revenues published in business plan, and used to set indicative charges, for RIIO-T1 period include incremental funding assumptions

1. The impact of including incremental is shown on the next slide (*based on setting charges in October for one year, with revised MARs from April to March)*
2. The impact of setting charges in April to align with formula / gas year to show impact on volatility is also included

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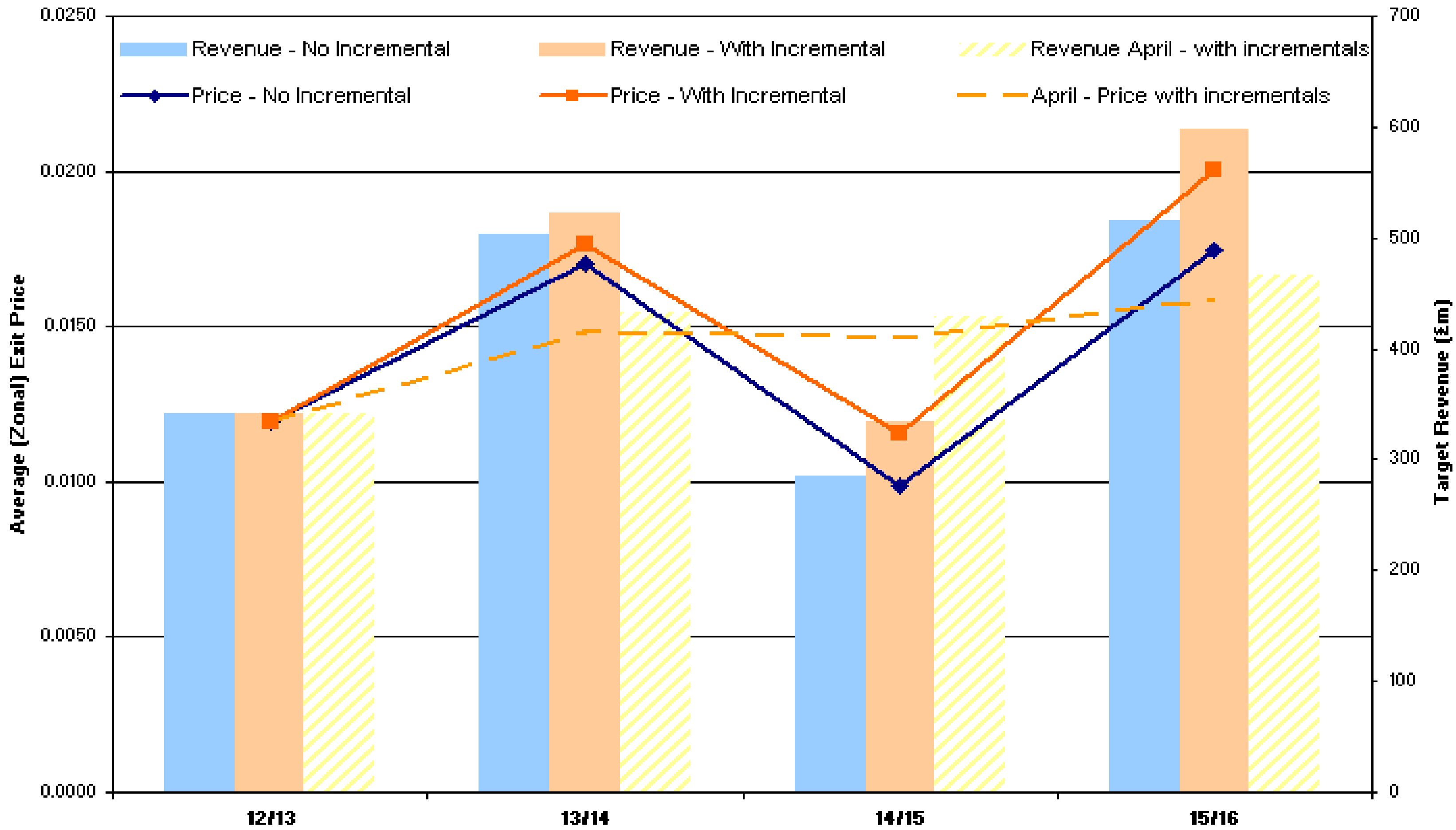
# RIIO-T1 Impacts on Charge Changes



# RIIO-T1 Initial Proposals Impacts on Charge Changes

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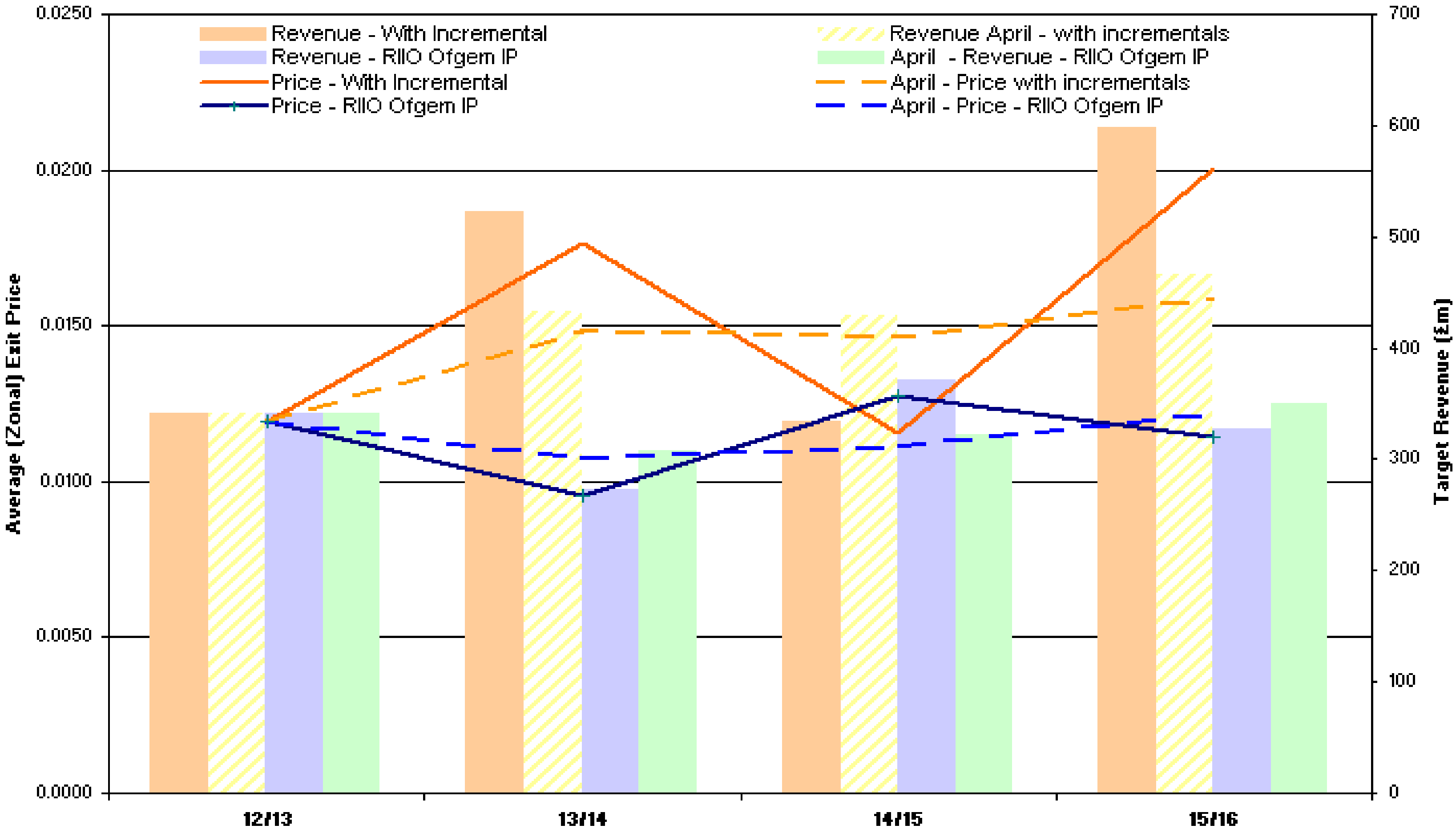

# Ofgem’s Charging Volatility Consultation

- 23 Reponses to the consultation
- Consultation considered five possible options in addressing volatility in charges – could be any combination not just one outcome
  - Option 1 - Improved information for suppliers and customers
  - Option 2 - Restricting the frequency of intra-year charge changes
  - Option 3 - Increasing the lag on incentive rewards/penalties that networks recover through allowed revenues
  - Option 4 - Increasing the lag on adjustments to allowed revenues from uncertainty mechanisms
  - Option 5 - Imposing a cap and collar on changes to allowed revenues

# High level overview of responses

| | Option Detail | High level responses |
|---|---|---|
| Option 1 | Improved information for suppliers and customers | • Supportive, providing information is informative, understandable and clearly explained. |
| Option 2 | Restricting the frequency of intra-year charge changes | • Supportive of less frequent changes and having sufficient notice periods<br>• No major issues identified in accommodating a single change in April<br>• This may delay step changes without intra year changes for necessary adjustments |
| Option 3 | Increasing the lag on incentive rewards/penalties that networks recover through allowed revenues | • Broadly Supportive. Fits with RIIO-T1 proposals<br>• Concerns by some on cash flow risks on certain costs. |
| Option 4 | Increasing the lag on adjustments to allowed revenues from uncertainty mechanisms | • Mixed responses with some in favour of increasing the lag and some not in favour of a change to increase lags on adjustments. |
| Option 5 | Imposing a cap and collar on changes to allowed revenues | • Mixed responses with some in favour of imposing a cap and collar and some not in favour of a cap and collar limit. |

- Options 1, 2 and 3 attract most favourable responses on the whole
- Options 4 and 5 have mix of those for and against

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# Potential Way Forward

- Bring any potential options back to NTSCMF for discussion subject to Ofgem's network charging volatility consultation
- Timing of changes
  - Compliant with our licence conditions for revenue recovery
  - Alignment of MAR change and charge change? (i.e. April)
- Transparency
  - Work with industry to develop

- Next NTSCMF – Early September
  - Updates from volatility consultation
  - Entry Charges review

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# TO Exit Commodity Charge

# TO Exit Commodity charge

- Introduction 1 October 2012
- Ensures that where booked < baseline, correct TO Exit revenue is collected
- Initially set to recover allowed revenue 12/13
- Going forward 2 options to give 12 months view:

1. Publish a 12 month profile with a change in April
   - Allows NG to recover correct revenue
   - Creates more stable charge for shippers
2. One rate kept the same until Oct 13
   - Also allows NG to recover correct revenue
   - But creates unstable charges

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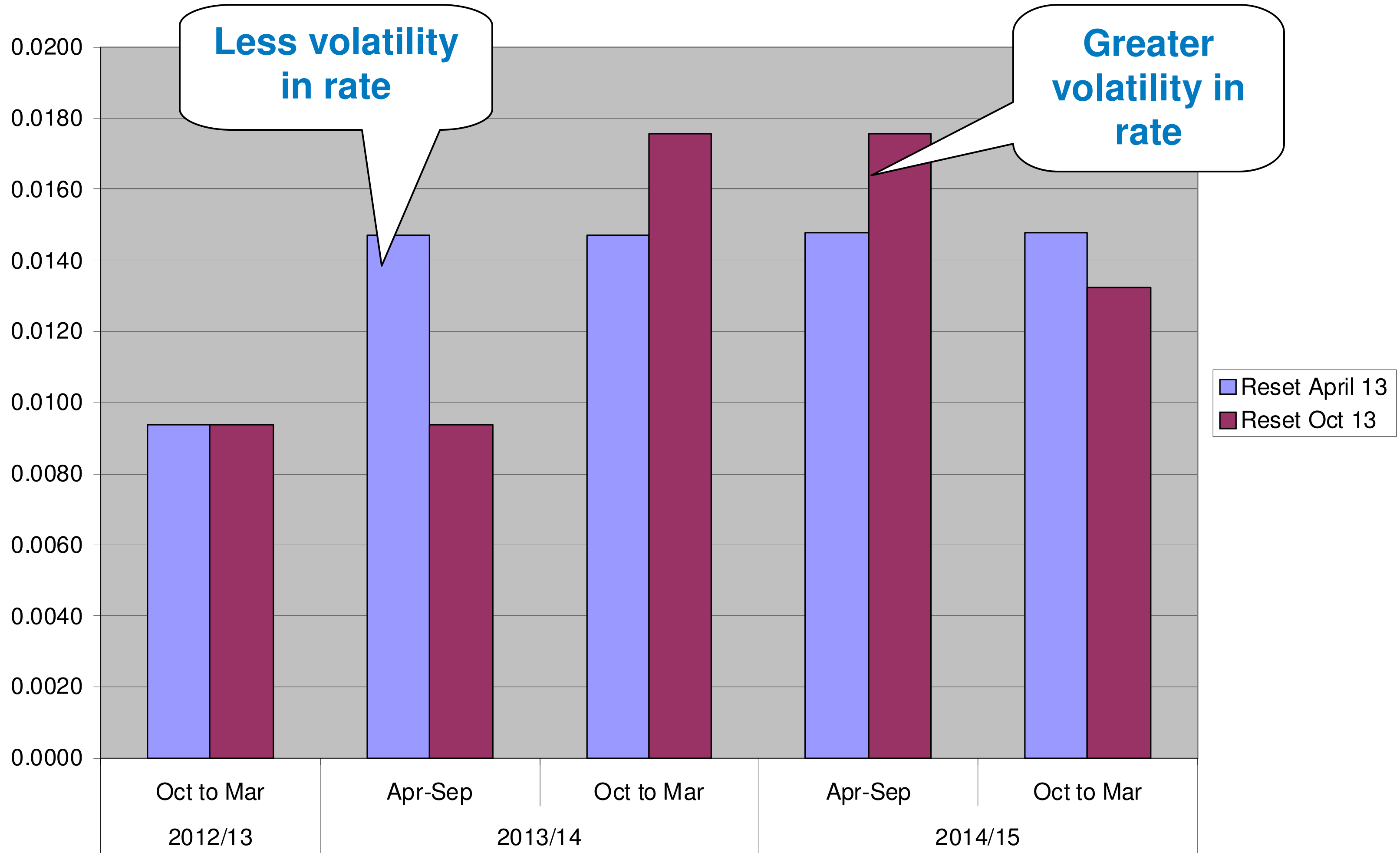
# Variations in TO Exit commodity charge




**Illustrative rates only**

## National Grid’s proposal

1. Publish: rate from 1 Oct 12 to 31 Mar 13

   rate from 1 Apr 13 to 30 Sep 13

   based on forecast revenue for 13/14 and current booking levels

2. In Jan 13, review rate for April

   based on - new information on RIIO

   - new bookings