gaslink
Gas System Operator

Mr. Tim Davis
Chief Executive
Joint Office of Gas Transporters
First Floor South
31 Homer Road
Solihull
West Midlands
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6th January, 2012

Re: 0356/0356A: Demand Data for the NTS Exit (Flat) Capacity Charges Methodology

Dear Tim,

Please find attached the Gaslink formal representation relating to the Draft Modification Report for the above Modification Proposals. Gaslink makes this representation in its capacity as operator of the network downstream of Moffat. Below we summarise the key points of our representation.

Gaslink position on the Modifications

Gaslink supports implementation of Mod.0356 because:

- Use of forecast data, generated by National Grid in accordance with a consistent and transparent methodology used for all exit points, offers a reliable method of calculating prices.
- This is much more likely to avoid the over or under-statement of peak day flows that arises through use of bookings, and consequently will result in more cost reflective prices (furthering the cost-reflectivity objective), and reduced cross-subsidy (furthering the competition objective).
- Mod.0356 also avoids undue discrimination by the consistent use of forecast data for all types of exit point, and this aspect would also further the competition objective.

Gaslink opposes implementation of Mod.0356A because:

- Use of capacity booking data within the charging methodology would lead to unrealistically high peak day flow assumptions at certain exit points (such as Moffat), whilst other exit points where short term bookings predominate would have unrealistically low peak day flow assumptions.

- This would result in charges that are not cost reflective (to the detriment of the cost-reflectivity objective), and give rise to cross-subsidy between Shippers (to the detriment of the competition objective).
- Furthermore, Mod.0356A selectively uses booking data for certain exit points and zero flow assumptions for others, without any rigorous underlying rationale. This is unduly discriminatory and detrimental to the competition objective.

Please do not hesitate to contact me if you would like to discuss any aspect of this.

Yours sincerely,

Celine Hayes

Celine Hayes,
Manager – Transportation Projects

Representation

Draft Modification Report

0356/0356A: Demand Data for the NTS Exit (Flat) Capacity Charges Methodology

Consultation close out date: 06 January 2012

Respond to: enquiries@gasgovernance.co.uk

Organisation: Gaslink Independent System Operator Limited

Representative: Celine Hayes

Date of Representation: 6th January, 2012

Do you support or oppose implementation?

0356 - Support~~/Qualified Support/Neutral/Not in Support/Comments~~* *delete as appropriate*

0356A - ~~Support/Qualified Support/Neutral/~~Not in Support~~/Comments~~* *delete as appropriate*

If either 0356 or 0356A were to be implemented, which would be your preference?

Prefer 0356 ~~or 0356A~~ *delete as appropriate*

Please summarise (in one paragraph) the key reason(s) for your support/opposition.

The key reasons for our support of Mod.0356 and opposition to Mod.0356A are as follows:

0356

Use of forecast data, generated by National Grid in accordance with a consistent and transparent methodology used for all exit points, offers a reliable method of calculating prices. This is much more likely to avoid the over or under-statement of peak day flows that arises through use of bookings, and consequently will result in more cost reflective prices, and reduced cross-subsidy. Mod.0356 also avoids undue discrimination by the consistent use of forecast data for all types of exit point, and would therefore further the competition objective.

0356A

Use of capacity booking data within the charging methodology will lead to unrealistically high peak day flow assumptions at certain exit points (such as Moffat), whilst other exit points where short term bookings predominate will have unrealistically low peak day flow assumptions. This will result in charges that are not cost reflective, and give rise to cross-subsidy between Shippers. Furthermore, Mod.0356A selectively uses booking data for certain exit points and zero flow assumptions for others, without any rigorous underlying rationale. This is unduly discriminatory and detrimental to the competition objective.

Are there any new or additional issues that you believe should be recorded in the Modification Report?

None

Relevant Objectives:

How would implementation of either of these modifications impact the relevant objectives?

Reflecting the costs incurred by the licensee in its transportation business

Cost reflectivity is a key principle in the determination of NTS Exit Charges and cross subsidisation must be avoided between different system users.

The use of capacity booking data in setting peak day exit flows for price modelling purposes under Mod.0356A could result in overstated peak day flows for certain exit points and understated peak day flows for others. This would result in higher prices than required to reflect costs where flows are overstated and lower prices at exit points where projected flows are understated. A methodology constructed on this basis would clearly not be cost reflective.

Capacity booking levels following the 2011 application window demonstrate the over and under-statement of peak day flows. The enduring capacity held at the Moffat exit point, for example, is around 435 GWh/d which is greater than current and likely future peak day flows. Conversely, there are other exit points where very low (or zero) levels of enduring or annual capacity are held. These bookings are an understatement of likely peak day flows in situations where annual or daily capacity is booked closer to the gas flow day.

It is clear that the capacity bookings to be used under Mod.0356A will in many cases not reflect peak day flows – as we have seen at entry, booking levels and timings are influenced by behavioural factors, especially where there are perceptions of scarcity or surplus. This is key as it is the peak day flows which actually drive costs.

Below we use a hypothetical example to illustrate the impact of over and under-statement of peak day flows for pricing purposes. Consider two exit points where the peak day flow is 50 GWh/d, and for which the transportation costs and hence the capacity charges are equal when the 50 GWh/d flow assumption is used for pricing purposes. In this situation the charging methodology gives prices which are cost reflective. Now consider the situation where one of the exit points has a booking level much higher than the peak day flow, say 100 GWh/d, whereas the other has a much lower booking level, say zero GWh/d. All other things being equal, the prices generated under the Mod.0356A methodology will be higher for the exit point with the 100 GWh/d booking than for that with the zero booking, despite the fact that the costs associated with each exit point are the same. In this situation Mod. 0356A results in charges that are not cost reflective.

In contrast with Mod 0356A, use of forecast data under Mod.0356 offers a more reliable method of calculating prices. Forecasts are generated by National Grid in accordance with a consistent and transparent methodology and its licence obligations, ensuring equal treatment of all exit points. This is much more likely to avoid the over or under-statement of peak day flows that arises through use of bookings, and consequently will result in more cost reflective prices.

This point is linked to that made in the Draft Modification Report – that Mod.0356 might be expected to better reflect investment costs than 0356A because NTS planning takes into account information beyond capacity bookings, and reflects National Grid's forecasts.

Interaction with reformed exit regime

Mod.0356A could also be viewed as undermining some of the improvements in cost reflectivity that the reformed exit regime was intended to achieve. One of these was that sites formerly taking interruptible service that were not in practice interrupted should pay charges that better reflect the service received. Clearly, exit points where short term (annual, daily, or off-peak) capacity is booked will under Mod.0356A generally have lower charges than equivalent points where long term bookings are made, despite the fact that a firm service is provided in both cases. Cost reflectivity is compromised as a result.

Further, there is an incentive to book shorter term capacity under Mod.0356A as this generally results in lower charges. To the extent this occurs, less accurate investment signals will be provided, again undermining one of the key objectives of exit reform.

Conversely, the use of forecast data for pricing purposes under Mod.0356 should not be seen as undermining the user commitment model as the fundamental principle that booking levels are used to guide investment decisions is maintained. The calculation of price needs to be cost reflective, not dependent on booking behaviour.

Taking account of developments in the transportation business

Both modifications attempt to address the fact that the existing pricing methodology has become unworkable due to the high assumed demand levels. However, this relevant objective requires consistency with the cost reflectivity objective and as noted above, we believe Mod.0356A is not cost reflective.

Facilitating effective competition between gas shippers and between gas suppliers

Cross-subsidy

The non-cost reflective nature of the Mod.0356A pricing methodology would lead to cross-subsidies between Shippers which would be detrimental to the competition objective. By contrast, improved cost reflectivity under Mod.0356 would reduce cross subsidies and thereby further facilitate competition.

Undue discrimination

There is an inconsistent and selective treatment of different types of exit point under Mod.0356A which we regard as unduly discriminatory, and therefore detrimental to the competition objective. Whilst Mod.0356A uses capacity booking levels for peak day flow assumptions for the majority of exit points, zero exit flow assumptions are used for bi-directional points. No rationale for this approach is provided.

The approach results in starkly different treatments for certain exit points, for example the Moffat Interconnector and the Bacton (IUK) Interconnector exit points. The Moffat exit price is based on booked capacities of around 435GWh/d whilst the exit price for the Bacton (IUK) Interconnector (which we understand has booked exit capacity of over 550GWh/d) is based on zero assumed peak day flow.

There is certainly an argument that exit flows on the peak day at bi-directional sites such as the Bacton (IUK) Interconnector or storage are unlikely to be at the level of booked exit capacities, but we contend that the exit bookings at other exit points, for example Moffat, are also unrealistic and unrepresentative of likely peak day flows, and that special treatment would also be required under the Mod 356A approach to address this.

Mod.0356 avoids undue discrimination and the need for special treatments by the consistent use of forecast data for all types of exit point, and would therefore further the competition objective.

We do not accept the argument advanced by certain Shippers that effectively there is no distinction between the modifications, as both would assume zero peak day flows for bi-directional sites. The distinction is the consistent application of forecast data for all exit points under Mod.0356, compared with the selective and unduly discriminatory use of either booking data for certain exit points or zero flow assumptions for others, without any rigorous underlying rationale.

Furthermore, we believe that fixing assumed bi-directional interconnector exit flows at zero under Mod 0356A is far too restrictive and would not allow the price modelling to reflect changes in market conditions – market prices either side of a bi-directional interconnector should dictate the direction and level of flows. Again this would be detrimental to the competition objective.

Mod.0356 deals with this point because it uses forecasts for bi-directional interconnector exit flows which can adjust to changing circumstances, albeit that the current forecast is zero.

Transparency, predictability and stability of charges

These factors are important considerations in terms of the competition objective and can be met via Mod.0356 whereas issues of cross-subsidy and undue discrimination factors are not met via Mod.0356A, as discussed above. We accept that there may be additional marginal transparency benefits associated with the codified nature of bookings used under Mod.0356A, but this is overwhelmed by the disadvantages associated with the lack of cost reflectivity, cross-subsidy and undue discrimination.

Impacts and Costs:

What analysis, development and ongoing costs would you face if either of these modifications were implemented?

None

Implementation:

What lead-time would you wish to see prior to either of these modifications being implemented, and why?

The modification should be implemented in Q1 2012 to allow calculation of prices for the 2012 application window and the 2012/13 gas year.

Legal Text:

Are you satisfied that the legal text will deliver the intent of either of these modifications?

The legal text for Mod. 0356 should make clear, as per the proposal text, that the assumed peak day flows at bi-directional exit points are forecasts, rather than always fixed at zero.

Is there anything further you wish to be taken into account?

Please provide any additional comments, supporting analysis, or other information that that you believe should be taken into account or you wish to emphasise.

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