Representation - Draft Modification Report 0541A/B

Removal of uncontrollable UNC charges at ASEPs which include sub-terminals operating on a 06:00 - 06:00 Gas Day

Responses invited by: 5pm 11 April 2016	
Representative:	Lucy Manning
Organisation:	Gazprom Marketing & Trading
Date of Representation:	11 April 2016
Support or oppose implementation?	0541A - Support 0541B - Support
Alternate preference:	*If either 0541A or 0541B were to be implemented, which would be your preference?* No preference
Relevant Objective:	**d)** Positive **g)** Positive

Reason for support/opposition: Please summarise (in one paragraph) the key reason(s)

When the NTS Gas Day changed to 05:00-05:00 UKT in October 2015 in response to EU Network Codes, the majority of UK gas beach processing sub-terminals remained on a 06:00-06:00 UKT Gas Day. The mismatch in Gas Days, and associated requirement to 'translate' 06:00 Gas Day data to 05:00 Gas Day data, inadvertently places shippers out of balance, triggering a number of charges. GM&T believes these charges are unwarranted, damaging to competition and not compliant with the relevant EU regulations. These modifications aim to disapply those UNC charges which are levied on shippers as a direct result of 'time-shift' mismatches, restoring the correct incentives to balance, facilitating compliance with EU regulations and improving competition.

The EU Balancing Network Code clearly sets out that balancing rules should financially incentivise shippers to balance their portfolios via cost reflective imbalance charges, reflect genuine system need, be non-discriminatory and avoid cross-subsidisation. GM&T believes the 'time-shift' related charges do not meet these requirements, for the reasons outlined in the Impact Assessment and Appendix 2 of the Workgroup Report. In summary:

- 'Time-shift' related charges do not **financially incentivise** shippers to balance because the charges arise from a mere accounting exercise which converts 06:00-06:00 data to 05:00-05:00 data during the following month, therefore shippers at 06:00 Gas Day terminals are neither able to predict nor control their 'time-shift' volumes.

- 'Time-shift' imbalances are synthetic, not real, physical imbalances. NGG takes balancing actions in response to physical imbalances however no balancing actions are required to manage synthetic imbalances which arises solely as a result of an after-the-month accounting process. Therefore the charges applied as a result of 'time-shift' mismatches neither reflect **genuine system need** nor are **cost-reflective** (since there are no costs). The only additional cost is to the shippers who have to pay these additional charges.

- The charges are **discriminatory**, since they are unjustified and are only applied to a certain sub-set of shippers.

- The monies collected via these 'time-shift' imbalance charges are then redistributed to all shippers via the neutrality mechanism. Given the above arguments, which demonstrate the charges are unwarranted, this redistribution of monies can be seen to be a **cross-subsidy** which undermines competition.

The other costs associated with these imbalances are similarly unwarranted and undermine competition by targeting certain shippers in a similar way.

Implementation: *What lead-time do you wish to see prior to implementation and why?*

GM&T supports implementation as soon as possible to reduce the time that it applies retrospectively and minimise undue negative impact on Users.

Impacts and Costs: *What analysis, development and ongoing costs would you face?*

GM&T faces no analysis, development or ongoing costs due to implementation. On the contrary, we do expect to face significant costs if neither modifications is implemented. These costs may be in the form of imbalance or other charges under UNC, or indirectly from the impact of non-implementation on industry, e.g. decline in retro-trading as evidenced in the CVSL's presentation at the recent Gas Day Industry Workgroup and more generally the potential decline in liquidity. We note that several major shippers have already stopped being active in retro-trading.

GM&T would like to reiterate that the 'time-shift' imbalance cost estimates contained within the modification report are likely to be an underestimate of the true costs. Particularly in relation to Overrun Charges, since these estimates were based on GM&T's original cost estimates, not on NGG's later, more accurate data, reflecting the effects of within-day flow profiling and the effects of 'netting off' at an individual shipper level and therefore showing higher costs.

Furthermore, there may be upcoming changes to NTS transmission costs as a result of Ofgem's Gas Transmission Charging Review conclusions paper, the EU Tariff NC and the newly launched wider GB charging review. This should be taken into account when reviewing the cost estimates within the Workgroup Report. This relates particularly to how NGG will recover its revenue (capacity or commodity charges) and the relationship between various prices for products (multipliers for within-day, monthly (to which Overrun Charges are indexed) and quarterly capacity). If the cost of within-day capacity increases, the cost of acquiring capacity and the cost associated with Overrun Charges will be significantly higher than the forecast reflecting today’s prices. These costs are already significant, but are avoided by the abundance of free within-day capacity. Any change to the tariff structure could lead to higher costs. This in turn could impact liquidity at the affected terminals, increase the cost of gas and quantity of money to be redistribution via the neutrality pot as a result of 'time-shift' related charges, whilst not affecting NGG's management of the system.

Due to the significantly lower costs of an online solution (£100k to £300k v. £500k to £1 mln), we would prefer that the offline solution be implemented.

Legal Text: *Are you satisfied that the legal text will deliver the intent of the Solution?*

Overall, yes.

In relation to the Retrospective Adjustment, we would prefer that the 30 day timeline for users at 06:00 sub-terminals to provide their daily 'pseudo' Entry Allocation Statements for the retrospective period be extended. We suggest that more than 30 days may be required to allow CVSL time to make the necessary systems changes to allow users to access that data.

Modification Panel Members have requested that the following questions are addressed:

Q1: Respondents' views are requested on the applicability of User Pays arrangements, with supporting reasons.

The modifications facilitate better compliance with the EU Balancing Network Code and, as such, the cost ought to be borne by NGG, using the allowance they receive to introduce code modifications required to implement the EU Network Codes.

NGG has previously argued its implementation of the EU Balancing Network Code is complete. GM&T disagrees on the grounds that the Gas Day change is not implemented fully or properly; NGG was aware of the 'time-shift' problem prior to implementing the Gas Day change but elected not to address it. GM&T believes the new Gas Day should have been implemented taking into account wider impact on industry.

The current arrangements are in contravention of the EU Balancing Network Code as imbalance charges on 'time-shift' volumes are not cost reflective and nor do they properly incentivise shippers to balance (see response to next question for more detail on this). They also result in money being redistributed to other shippers via the neutrality mechanism, effectively creating a cross-subsidy and undermining competition.

Industry discussions on the impact of the Gas Day change began long before the implementation date, such that NGG was well aware of the negative impact of their implementation plans before 1 October 2015 and these modifications had in fact been raised several months prior to 1 October 2015. Therefore the fact that NGG did not propose a mechanism that maintained the integrity of the balancing and entry capacity booking regimes is perceived as a failing which these modifications are seeking to rectify.

Q2: Respondents' views on the ***six key areas*** *of impact described in the Impact Assessment, in Section 4, of the Draft Modification Report are also invited.*

Perhaps it would be useful to note that the Claims Validation Agency (CVA) does not affect the volumes of gas entering the NTS. Instead, the CVA allocates the gas entering the NTS to shippers by proportionally matching measured volumes against shipper claims for the gas. This is a process that is done the month after.

At 05:00-05:00 terminals, any differences between a shipper nomination and the final volume allocated to a shipper by the CVA reflects the difference between the information provided by the production terminal to the shipper on a given Gas Day and the actual gas produced on the same day. These differences at gas terminals are normal because production naturally fluctuates, which physically affects the NTS. By adjusting shippers' claims to match measured volumes, the CVA allows NGG to identify which shipper injected additional or less gas into the system (by comparing nominations against the updated allocations) and apply imbalance and other charges.

On 06:00-06:00 terminals, shippers face an additional change in their allocations, due to the application of the 05:00-05:00 algorithm. This algorithm is also applied one month later and identifies the owners of the volumes entering the NTS on a 05:00-05:00 basis. Because shippers at these terminals are only provided 06:00-06:00 information, significant differences ('time-shift mismatches') arise between shipper nominations and allocations. However, whereas some of these differences reflect actual physical variations in flows at these terminals (like the differences measured at 05:00-05:00 terminals), the majority actually reflect the conversion of ownership of gas from a 06:00-06:00 basis to an 05:00-05:00 basis. In reality, the gas entering the NTS was not affected by this conversion and this conversion does not reflect a real physical change in actual volumes entering the NTS. NGG has not changed the way it operates its system because of this algorithm and has not incurred additional costs which would justify the charges it is charging to shippers.

Furthermore, as explained in the cost benefit analysis in the modification report, the application of the algorithm is totally unrelated to and unaffected by shipper nominations. Shippers cannot influence the way the algorithm is applied and are also unable to reduce 'time-shift mismatches' by nominating "better" due to the fact that the final conversion of allocations to 05:00-05:00 also depends on the behaviour of other shippers and production sites at the same terminal and flows on the previous and following gas days.

Our summarised opinion about current system needs and operations of the NTS is that they have remained unaffected by the introduction of the new Gas Day, despite shippers being charged more. As a result, we have a more expensive system that does not operate any differently.

1. Compliance with EU Legislation

According to the relevant regulations, imbalance charges ought to (i) financially incentivise shippers to balance, via cost reflective imbalance charges which take into account the prices associated with TSO's balancing actions (Art 21.3 of the Gas Regulation and Art 4.2 and 19.3 BAL); (ii) reflect genuine system need (Art 21.1 Gas Regulation and Art 4.2 BAL); (iii) be non-discriminatory (Art 1(a) Gas Regulation and BAL Recital 4); and (iv) avoid cross-subsidisation (Art 21.3 Gas Regulation).

Any imbalance charges accrued as a direct result of the 'time-shift' mismatch are in contravention of the above rules. The charges do not incentivise shippers to nominate accordingly because 'time-shift' mismatches are the result of an accounting exercise (calculated the following month) that simply converts 06:00-06:00 allocations to 05:00-05:00. No charge will alter the fact that shippers have no information about, or control over, the 'time-shift' volumes (see response to point 3 "incentives to balance", below, for further information).

The charges do not arise due to genuine system need. They arise as a result of a recent change to after-the-month gas-accounting procedures, and therefore are not cost-reflective – for the simple reason that there are no costs of undertaking any associated balancing action.

Given the above, the charges are discriminatory, since they are unjustified and are only applied to Users at affected terminals. As a result, there is inherent cross-subsidisation, since the monies raised from specific terminals are distributed among all shippers on the NTS via the neutrality mechanism (rather than being used to pay for the cost of a genuine balancing action).

NGG has indicated concern that implementation of the proposals may undermine the legal basis of the 05:00 Gas Day. GM&T does not believe this is the case. Allocations and nominations at Entry and Exit will continue to be provided on a 05:00 Gas Day basis and imbalance charges calculated accordingly. Furthermore, in relation to 0541B, the ex-post reconciliation using the existing neutrality adjustment is clearly consistent with the mechanism allowed for within the EU Balancing Network Code (30.6): "...*methodology for the calculation of the neutrality charge for balancing may provide rules for the division of the neutrality charges for balancing components and the subsequent apportionment of the corresponding sums amongst the network users*...".

2. Physical Needs

There is a distinction between physical imbalances and the synthetic imbalances, created by the 'time-shift' mismatch. The method of calculating charges associated with shipper imbalances needs to recognise this distinction. The 'time-shift' mismatches neither result in nor reflect physical changes to the system and do not, therefore, result in NTS balancing actions and associated costs. They are generated purely as a result of gas-accounting processes that take place in the following month.

The modifications aim to restore the correct financial incentives to balance, since the charges will continue to be applied for imbalances arising from physical imbalances.

During the modification development process, it was established that 'time-shift' mismatches do not reflect nominations and nor are shippers able to influence 'time-shifts' through nominations. Moreover, any additional discrepancies between allocations and nominations would automatically be considered as physical imbalances and shippers would be charged accordingly, thus preserving the reasonable endeavour obligation and incentives to nominate accurately.

Without these modifications, Users at 06:00 terminals are likely to incur NTS Daily Imbalance Charges, Scheduling Charges, Overrun Charges and potentially Incentivised Nomination Charges as a direct result of the 'time-shift' mismatches, not as a result of any physical system imbalance or balancing actions.

3. Incentives to Balance

The current imbalance charges do not act as an incentive to balance because they have no impact on shipper nominating behaviour.

The only data shippers inputting gas to the NTS from 06:00 terminals have to base their nominations to NGG, and claims to the CVA, on is 06:00 data. They are not wilfully choosing to use this data instead of 05:00 data.

Shippers only become aware of their 'time-shift' mismatches the following month. The calculations depend on a variety of factors. Figure 12 in the Workgroup Report and the associated example demonstrate that the charges cannot be said to incentivise shippers to balance, in a large part due to the fact that their 'time-shift' mismatch is also affected by other users at the sub-terminal and flows on adjacent Gas Days. As a result, charges for synthetic imbalances neither reflect real system needs nor do they have any influence on shipper nominations.

Given the above, we believe the responsibility is on those who believe the current imbalance charges *do* act as an incentive to provide evidence to justify this and counter the arguments provided in this response and in the modification report. In particular, as part of the workgroup discussions and other industry discussions since summer 2015, we note that no party has been able to demonstrate that the current arrangements *do* indeed incentivise nomination behaviour in an appropriate way and both reflect genuine system need and are cost reflective, as foreseen by the EU Balancing Network Code.

4. Impacts on Charges and Neutrality

GM&T notes from the Workgroup Report that NGG believe the modification proposals result in a socialising of costs to all shippers via the neutrality mechanism when these costs should be targeted at only a sub-set of shippers. GM&T strongly disagrees with this claim on the basis that these costs do not exist and it is therefore not possible that they are being socialised.

Although charges are accrued by 06:00 shippers, there is no underlying cost. If there were any costs, then the imbalance charges should be designed to reflect those specific costs (acquiring/disposing of gas to balance), not to pass money on to other shippers across the wider network.

In summary, since these charges do not meet the necessary requirements for imbalance charges in the EU Balancing Network Code (either by reflecting real costs or by incentivising shippers), the monies accrued and redistributed across system Users constitute a cross-subsidy. GM&T believes the modifications redistribute the neutrality pot in the correct way. They attempt to remove cross-subsidies created by charging a sub-set of shippers for phantom imbalances and passing that money to other shippers.

5. Effect on Competition

Competition will be better facilitated when charges are accrued fairly and cross-subsidies are minimised. Both modifications facilitate this. It is worth mentioning that larger shippers bringing in gas to the NBP from multiple NTS points are less impacted by time shift charges because a smaller portion of their portfolio is delivered at 06:00-06:00 Terminals. However, a smaller shipper whose volumes are mostly delivered at 06:00-06:00 terminals is less able to absorb these charges and therefore disproportionately impacted. The same argument applies to a producer delivering across multiple beach terminals (both 05:00-05:00 and 06:00-06:00) compared with a producer of a one or two offshore sites delivering at the same 06:00-06:00 terminal only.

Additionally, the high costs associated with not implementing these modifications has already acted as a deterrent to shippers taking part in beach trading and retro-trading (whose liquidity has dropped significantly).

The current situation also unduly discriminates against the production of domestic gas at 06:00 Gas Day Terminals whilst favouring gas imports. As demonstrated in the cost-benefit analysis on pages 26 and 27 of the Workgroup Report, after the GB charging review is complete the Overrun Charges may be significantly higher and the discriminatory effect would be proportionally greater.

The effect of changes in shipper and trader behaviour may be seen more widely and could impact liquidity.

6. Justification for Retrospectivity

GM&T fully agrees that all 3 of Ofgem's conditions for retrospectivity are satisfied, for the reasons outlined in the Workgroup Report.

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

The question should be asked whether applying these charges would indirectly incentivise producers to provide more accurate flow information to shippers. Unfortunately, this is not likely. Firstly, standard beach contracts (Beach 6-6 2015) between a shipper and a producer state that although any imbalances, overruns or scheduling costs incurred by a shipper on a given gas day can be passed on to the producer, this right explicitly excludes any 'time-shift' related costs, which the shippers are left to deal with.

Secondly, the reason the UK has two different Gas Days, is precisely because it is prohibitively expensive to make the changes that would provide more accurate information. This has been explained multiple of times when gas producers learnt about the new Gas Day. Were these costs not so high, terminals may move to operating on a 05:00-05:00 basis.

Finally, the uncertainty faced by 06:00 sub-terminal shippers has been likened to the uncertainty experienced by other parties in the industry, such as shippers delivering gas to end-users. The differences between these cases are outlined on page 16 of the Workgroup Report and are important to reiterate here.

Primarily, it should be noted that the uncertainty in the case of supplying end-users reflects actual physical demand and flows (there is no reallocation of volumes among Users). Shippers at 06:00 sub-terminals face penalties arising not only from errors in forecasting actual physical flow but also from the conversion of data from one Gas Day to another, a mere accounting issue.

Whereas incorrect nominations reflecting physical variations both upstream and downstream may have an impact on the physical operation of the system and, as such, should be targeted with imbalance penalties, there are no system or operational costs caused by the conversion of data - there cannot be, since these are only confirmed the month after the event.

Furthermore, 06:00 sub-terminal shippers do not have the forecasts, risk-mitigation options or any element of control over these charges, as is the case with end-user suppliers.