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:	Phil Lucas
Organisation:	National Grid NTS
Date of Representation:	11th April 2016
Support or oppose implementation?	0541A - Oppose 0541B - Oppose
Alternate preference:	*If either 0541A or 0541B were to be implemented, which would be your preference?* 0541B
Relevant Objective:	**d)** Negative **f)** Negative **g)** Negative

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

National Grid NTS does not support implementation of either of these Proposals as we do not believe that implementation will better facilitate the relevant objectives of the facilitation of competition (d), compliance with EU Regulations (g) nor efficiency in the implementation and administration of the Code (f).

In respect of objective (d), the proposed method of adjustment effectively requires the socialisation of a proportion of a User's imbalance costs (determined in accordance with the EU Balancing Code and the Uniform Network Code) to other Users via neutrality arrangements, which is indeed *detrimental* to competition by creation of cross-subsidies which would potentially have a discriminatory effect. In respect of objective (g), National Grid NTS believes that the prevailing balancing rules are compliant with EU Regulations and that implementation of either Proposal would in fact have the effect of making the balancing arrangements non-compliant with the detailed rules prescribing how imbalance charges are to be calculated in the EU Balancing Code. On this basis we do not believe that implementation would better facilitate relevant objective (g).

In addition, from a System Operator perspective, we believe that the need to 're-work' User's imbalance and neutrality positions from those initially calculated (as advocated by

these Proposals) would have a detrimental impact on relevant (f) 'efficiency in implementation and administration of the Code'.

Overall, the key driver for the solutions sought by these Proposals appears to be the stated lack of ability of certain Shippers to control risk due to insufficient communications between upstream parties and Users (provided for within the relevant upstream bi-lateral contractual terms). As recognised by the Proposers "*There is insufficient relevant information around final allocations for those Users operating at GMT Terminals at the time of operating…*"[1] However, if a User is in fact able to exert a level of control over this risk, we do not believe that it is appropriate for a 'solution' (to a number of bi-lateral upstream contractual issues at a subset of System Entry Points) to be sought in the multi-lateral downstream UNC arrangements which impact all Users.

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

National Grid NTS notes that a detailed assessment of implementation requirements has not been made as yet, however, we have expressed a preference for a Gemini based solution for the enduring arrangements. Based upon the assumption that systems implementation is required at the point of contractual implementation (notwithstanding the retrospective effect advocated by both Proposals) there is likely to be lead time required for implementation. The extent of this lead time requirement has not been identified as yet.

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

Changes will be required to Transporter Agency systems and therefore implementation will generate Transporter Agency costs. A High Level Cost (HLC) estimate has assessed the costs to be up to £1million for development with annual operating costs up to £20,000. If these are not subject to User Pays arrangements (see below for our views in respect of this matter), National Grid NTS will bear such costs.

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

National Grid NTS is satisfied that the legal text delivers the intent of the respective solutions advocated by these Modification Proposals.

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.

National Grid NTS firmly believes that Modification Proposals 0541A and 0541B are User Pays Modification Proposals. We note the direction provided in the User Pays Guidance Document (the "Guidelines") on best practice in relation to Cost Estimates and Cost Allocations relating to User Pays Modification Proposals (as referenced in paragraph 5.13 of the UNC Modification Rules):

[1] Draft Modification Report, page 23: '5. Effect on Competition' para 3

Page 3 Background to this document

> "*It is envisaged that any Modification Proposal which has the potential, or where it cannot be ruled out, to incur incremental Transporter Agency costs (associated with any Transporter Agency systems or processes) and/or creates or amends a User Pays Service, will be classified as a User Pays Modification Proposal.*
>
> *Where the Modification Proposal is not classified as a User Pays Modification Proposal this implies the Proposer is fully aware that there will be no incremental Transporter Agency costs associated with the Modification Proposal and/or that implementation of the Modification Proposal does not create/amend a User Pays Service.*
>
> *Where during development of a Modification Proposal the Proposer is made aware or becomes aware that the Modification Proposal will require changes to the Transporter Agency's systems or processes, that result in incremental costs being incurred by the Transporter's Agency and/or creates/amends a User Pays Service, then the Proposer should amend the Modification Proposal such that it takes the form of a User Pays Modification Proposal prior to the Modification Proposal entering the Consultation Phase.*"

On the basis of the above, and the requirement to make changes to Transporter Agency Systems (in the event of implementation of either Proposal), it is National Grid NTS's opinion that both 0541A and 0541B are User Pays Modifications and that the principal beneficiaries of the adjustment of certain UNC charges are those Shipper Users that would utilise this service. For this reason it is National Grid NTS's view that such a User Pays service should be funded by those Shipper Users that utilise this.

We note that the Proposers believe that the changes advocated by these proposals are necessary to ensure compliance with the EU Codes and should therefore be funded via RIIO-T1 EU market facilitation funding. For the reasons explained elsewhere in this representation, we do not agree that the proposed changes are necessary to comply with EU Codes. Further, we would observe that the change drivers in this case are akin, in principle, to those influencing the amendments to the 'shorthaul'[2] arrangements at the Bacton ASEP introduced by Modification 0534. The Ofgem decision in respect of this Modification recognised a distinction between those changes *required* for compliance with EU Codes and those *desired* (potentially by a subset of stakeholders) as a consequence, but nevertheless not strictly necessary for compliance. The changes proposed in this case fall into the latter (non-mandatory) category.

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.

1. Compliance with EU Legislation

   The Proposers have expressed the view in the Workgroup Report that " *the GB arrangements are in contravention of the BAL Network Code* " and that the two Modification Proposals seek to " *ensure that the UNC is fully compliant* "[3] We do not believe that the existing regime is non-compliant and therefore do not

[2] NTS Optional Commodity rate as per UNC TPD B1.8.5(d)
[3] Draft Modification Report, page 13: 'User Pays'

believe there was a requirement (or indeed an obligation) to implement any further arrangements and therefore National Grid NTS not doing so was certainly not *"…a failing on its part…*" as suggested by the Proposers.

The process of determination of the changes to the UNC arrangements necessitated by the EU CAM and Balancing Codes involved procurement of legal advice and a comprehensive set of industry engagement activities by National Grid NTS with a significant number of stakeholders including GB shippers, Ofgem, ENTSOG[4] and adjacent Transmission System Operators. We shared extensive impact analysis with GB industry and engaged GB stakeholders to verify the implementation steps required and the consequential UNC change proposals were approved by the Authority.

For the reasons outlined below we are concerned that implementation of either of these Proposals would in fact be non-compliant with EU Balancing Code. Conversely, the Proposers' view that the existing arrangements are non-compliant (and that implementation of either of the Proposals *would* ensure compliance) are based upon two assertions:

- the inability of the User to access a sufficient granularity of upstream data to forecast entry flows over a 05:00 to 05:00 period; and

- that a sub-set of Users should be legitimately treated differently in the calculation of imbalance charges.

The extent to which these two points are accepted either supports or undermines the Proposers' view on compliance. For example, Users may have a choice, or the ability, to forecast entry flows over a 05:00 to 05:00 period if investment was made to obtain a sufficient granularity of upstream data in which case the Proposers' arguments are less persuasive.

The ultimate effect of the GB balancing rules, and whether they achieve compliance with the substance of the EU Codes and regulations, is the most important factor in determining compliance. The outcome of the financial adjustments proposed is that 06:00 to 06:00 volumes at the relevant entry points are used to calculate imbalance charges. National Grid NTS does not believe that this is compliant with the detailed rules prescribing how imbalance charges are to be calculated in the EU Balancing Code, which requires imbalance charges to be calculated on the basis of inputs and outputs over a 05:00 to 05:00 gas day. It is certainly the case that the prescriptive rules do not envisage that they are calculated for different Users for different 'gas days' at certain entry points. Further, the definition of "balancing period" in Regulation 715/2009 envisages one balancing period being the same for all Users.

In respect of Regulation 715/2009, the Proposers suggest that prevailing arrangements are not consistent with a number of balancing rules principles. Our views on each are described in the following sections.

[4] European Network of Transmission System Operators for Gas

The Proposers note that EU Balancing Code Article 30(2) allows National Regulatory Authorities (NRA) to approve a methodology for the calculation of neutrality charges (and apportionment of such amongst Users) and suggest that this provides scope for the inclusion of an adjustment of imbalance costs to reflect 'Time Shift charges', thus being compliant with EU Balancing Code. However, it is open to question as to whether it was contemplated that this methodology would be used as a vehicle to effectively endorse the calculation of a sub-set of Users' imbalance costs based in part upon systems inputs measured over a different 24 hour period than that mandated by EU Codes.

Further, the proposers suggest that EU Balancing Code Article 30(6) affords the scope for UNC to permit redistribution of neutrality costs as proposed but we note this redistribution must *reduce* cross subsidies whereas National Grid NTS believes that the proposed redistribution is likely to *increase* cross subsidies.

In the event that Ofgem directs the implementation of either of these Proposals, National Grid NTS will need to consider whether to seek confirmation from the NRA (Ofgem) that such a direction is approval of the daily imbalance charge calculation methodology as required under Article 20 of the EU Balancing Code.

2. NTS Physical needs

National Grid NTS recognises that during development, both Proposals were de-scoped in terms of the proposed changes to UNC TPD Section C1.1.5 (Nominations) however it is nevertheless stated in the Draft Modification Report that Users at 'GMT' Terminals will "*only have Day Ahead and within Day information…and will nominate …based on 06:00 hours to 06:00 hours numbers*"[5].

We would note that pursuant to the above referenced section of the UNC, Users remain obliged to use all reasonable endeavours to submit nominations for the quantities expected to be delivered to the Total System each Day (as defined in the UNC as 05:00 to 05:00). Nominations accuracy remains important as this data remains one of the information sources that National Grid NTS is 'entitled to take into account'[6] (under UNC) and 'shall consider'[7] under the EU Balancing Code for the purposes of balancing the system.

We firmly believe that requiring balancing rules to reflect the genuine needs of the system (as referred to in the EU Balancing Code) means reflecting the needs of the system over a 05:00 to 05:00 gas day. Thereby, creating balancing rules to specifically cater for, or adjust use of system charges to effectively reflect a 06:00 to 06:00 gas day at a sub-set of entry points would appear to be contrary to this requirement.

3. Incentive to Balance

National Grid NTS acknowledges that the *prevailing* bi-lateral arrangements for information sharing between upstream parties and Users may inhibit the accurate forecasting of entry volumes over a 05:00 to 05:00 gas day. However changes to

[5] Draft Modification Report, page 4: 'Why Change?' para 4
[6] UNC TPD, Section D1.3.1
[7] EU Balancing Code, Article 6(2)

those arrangements, to allow a greater level of information sharing between these parties, could mitigate or eradicate this risk and accordingly would appear a more appropriate and proportionate step to take.

We note that the commercial capability to accurately forecast entry volumes is one of many drivers that influence a User's imbalance position; other drivers include, for example, the ability to accurately forecast demand. From this perspective, the effective removal of a proportion of the Users' commercial incentive to balance could create a precedent for the removal of other arguably 'legitimate' competitive imbalance drivers.

If the Proposers' assertion that they are not able to control the identified imbalance risk is accepted, there may be merit in the argument that an inability to respond to an incentive negates to some extent the effectiveness of that incentive

However, we note that Article 4(1) of the EU Balancing Code specifies a general principle that Users are responsible for balancing their respective inputs and outputs. Accordingly, whilst the System Operator should aim to have appropriate incentives in place for Users, it still remains the responsibility of the User to achieve a balance over the balancing period, regardless of whether the User is incentivised.

In addition, if 06:00 to 06:00 data *is* used to calculate imbalance charges, we nevertheless believe that this does not create cost reflective imbalance charges. Pursuant to both Regulation 715/2009 and the EU Balancing Code balancing charges should be reflective of the System Operator's costs for the genuine need to balance the system. As expressed above, we believe that cost reflectivity in this case means the costs needed to balance the system on a 05:00 to 05:00 gas day.

In respect of the examples shown in this section of the Impact Assessment within the Draft Modification Report, we would observe that Figure 3 appears to be suggesting that the existing regime may give rise to a scenario whereby the User's expectation of imbalance fortuitously does not materialise, however National Grid NTS is not able to apply imbalance incentives.

Acknowledging that a driver for imbalance may be the difference between the Shipper's expectation (nomination) and the reality (allocation), the example simply illustrates that that in the proposed regime a User's nomination volume may fortuitously be equal to its entry allocation. However, from a System Operator's perspective, the User's expectation (nomination) was 240 and the reality (allocation) was 240 hence appropriately there were no imbalance costs attributable to this.

4. Impacts upon charges and neutrality

The solutions proposed both seek to revise the imbalance positions of a subset of Users ('GMT Users') flowing gas into the Total System at the relevant System Entry Points, with the consequential revised imbalance costs being adjusted via existing energy balancing neutrality arrangements. As a consequence, to ensure that the system operator maintains a neutral financial position (neither losing nor gaining financially) these adjustments will have a financial impact on *all* Users with throughput.

Whilst the Proposers suggest this is not socialisation of costs (on the basis that the non-GMT Users' neutrality positions are incorrect prior to the adjustment), it is nevertheless the case that all Users' initial neutrality costs, legitimately calculated on the basis of an EU Codes compliant 05:00 to 05:00 gas day, will adjusted as a consequence of the adjustment of a subset of Users' (i.e. GMT Users) imbalance positions. An illustration of this is provided in Appendix A. National Grid NTS believes that this constitutes a socialised cost.

5. Effect on Competition

We note that Regulation 715/2009 requires that the balancing rules are non-discriminatory, however the implication of the implementation of either of these Proposals is that certain Users would be treated as a different class to other Users.

As described above, there is a substantial argument that adjustment of a subset of Users' imbalance positions via adjustment of all Users' neutrality costs (as proposed) is effectively a socialised cost creating cross-subsidisation. Further, it is not clear to National Grid NTS whether a number of upstream/shipper bi-lateral arrangements may have been revised (potentially at cost) to meet the requirements of the revised gas day. In this case, the benefit of such investment may be effectively negated if one of these Proposals is directed for implementation. Both of these factors could be argued as potentially being detrimental to competition by discriminating against any Users who have already taken steps to mitigate the identified imbalance risk.

What is apparent is that a number of sub-terminals have adopted a 05:00 to 05:00 gas day to align with the downstream arrangements, presumably at cost to them. One residual concern therefore is that the incentive for remaining 06:00 to 06:00 sub-terminals to move to a 05:00 to 05:00 will potentially diminish if downstream arrangements are revised via implementation of either of these Proposals.

As observed by ACER in its decision[8] not to proceed with an amendment of EU regulations to enable continuation of a 06:00 to 06:00 gas day in downstream GB arrangements:

> "*The mere fact that certain stakeholders face certain costs in implementing certain Network Code provisions certainly does not justify amending the Network Code, given that such costs are inevitable in the process of European harmonisation. Therefore, such costs would have to be weighted against the overall benefits such harmonisation brings*.
>
> *...the sunk costs of those already implementing the current provisions — such as the downstream sector, National Grid (UK), Gaslink (Ireland) and some producers — should have been taken into account in such a cost-benefit analysis.*
>
> *In addition, the Agency received the amendment request a year after the problem had been identified by the UK upstream industry, during which period*

[8] http://www.acer.europa.eu/Documents/Letter%20to%20OGUK_150318.pdf

important implementation steps have already been taken by midstream and downstream players."

6. Justification for Retrospectivity

It is suggested by the Proposer in the Draft Modification report that the "*fault or error occasioning the loss was directly attributable to central arrangements*" on the basis of shippers being "*charged for there being two different Gas Days*". As highlighted above, the key driver for loss in this case is not central arrangements but the lack of upstream information currently procured by GMT Shippers to effectively manage their risk. On this basis, the suggestion that central arrangements should be introduced to mitigate this risk appears unfounded given that such arrangements are not the driver for the 'loss'. Noting the absence of any *obligation* to develop a central system provision, the benefits case for such a solution is unclear given that certain upstream parties have already (or may in the future) adopt a 05:00 to 05:00 gas day.

Further, it is suggested that a driver for a subset of upstream parties not adopting a 05:00 to 05:00 gas day is the costs this would entail. National Grid NTS notes that this was cited as a justification for seeking an amendment of the EU CAM and Balancing Codes, however as stated in the ACER decision[9] these costs have not, as yet, been substantiated.

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.*

We have not identified any errors that we believe should be taken into account.

Please provide below any additional analysis or information to support your representation

Within Appendix 3 'Cost Benefit Analysis' of the Draft Modification Report the Proposers identified a potential capacity charge exposure (potentially purchased by Users as insurance against the risk of incurring Capacity Overrun Charges). It is recognised within the Draft Modification Report that the cost of such is currently low due to the availability of zero-priced within day-capacity.

In order to quantify this, National Grid NTS has reviewed the actual prices paid for capacity (average and maximum prices) between October 2015 and January 2016 at the six impacted Aggregate System Entry Points (ASEPs) and calculated the proportions these two parameters represent of the Monthly System Entry Capacity (MSEC) and Daily System Entry Capacity (DSEC) utilised in the Proposer's analysis (the DSEC value

[9] ACER decision not to propose the Network Code amendment request (18th March 2015): " *the Agency strived to understand whether the one-off costs for upstream producers to switch to a different Gas Day would not be outweighed by the benefits of improved market integration. This key element was not fully clarified by the parties and was not presented to the Agency in a detailed and differentiated manner* " see footnote 8

was utilised to derive the estimated £649,000 impact). It is worthy of note that both Daily Interruptible System Entry Capacity (DISEC) and Within Day System Entry Capacity (WDSEC), which were not utilised in the Proposers' analysis, have zero reserve prices.

As can be seen from the following table, in the review period only two of the six ASEPs had capacity prices greater than zero with the maximum proportion being the maximum price paid for capacity at the Bacton UKCS ASEP. This value represented 29% of the DSEC reserve price. It is also worthy of note that in the period covered by the analysis, zero priced capacity was available for over 65% of the volume used within the Proposer's analysis.

Aggregate System Entry Point (ASEP)	Proportion of Aggregate ASEP Volume Used in Proposers' Analysis	Actual Price as a Proportion of MSEC Reserve Price		Actual Price as a Proportion of DSEC Reserve Price	
		Average Price	Maximum Price	Average Price	Maximum Price
Bacton UKCS	27.1%	5.0%	19.2%	7.6%	29%
Barrow	4.7%	0%	0%	0%	0%
Easington	7.4%	0.6%	2.3%	0.9%	3.4%
St. Fergus	43.3%	0%	0%	0%	0%
Teeside	16.7%	0%	0%	0%	0%
Theddlethorpe	0.8%	0%	0%	0%	0%

Appendix A

The following table illustrates the operation of the energy neutrality mechanism which apportions all costs between market participants (Users A to H) in order to ensure that the System Operator (SO) remain cash neutral.

In this illustration, the 'Initial Neutrality Calculation' determines imbalance costs (driven by the respective imbalance volumes multiplied by the applicable System Marginal Price) which result in a net imbalance cost residue for the SO of ~£430 which is levied to all Users in proportion to their throughput (system input volume plus system output volume).

In the event of a subsequent 'Adjustment' (in this case the revision of Users A to C's system input volumes) this revises the imbalance costs of these three Users with any subsequent net imbalance costs (a residue of £8 for the SO in this illustration) levied to Users in proportion to their throughput (system input volume plus system output volume).

	Initial Neutrality Calculation								Adjustment							
Users	UDQI Volume	UDQO Volume	Imbalance Volume	Sum of UDQI and UDQO	Neutrality Proportion	Imbalance Costs	Neutrality Adjustment	Total	Revised UDQI Volume	Revised Imbalance	Sum of UDQI and UDQO	Neutrality Proportion	Adjusted Imbalance Costs	Imbalance Adjustment	Neutrality Adjustment	Adjustment Total
A	12,500	11,300	1,200	23,800	9.5%	£420.00	£40.89	£460.89	12,450	1,150	23,750	9.5%	£402.50	£17.50	£0.76	£18.26
B	1,570	2,070	-500	3,640	1.5%	-£255.00	£6.25	-£248.75	1,700	-370	3,770	1.5%	-£188.70	-£66.30	£0.12	-£66.18
C	1,260	1,260	0	2,520	1.0%	£0.00	£4.33	£4.33	1,180	-80	2,440	1.0%	-£40.80	£40.80	£0.08	£40.88
D	1,760	1,610	150	3,370	1.3%	£52.50	£5.79	£58.29	1,760	150	3,370	1.3%			£0.11	£0.11
E	35,820	36,540	-720	72,360	28.9%	-£367.20	£124.32	-£242.88	35,820	-720	72,360	28.9%			£2.31	£2.31
F	12,340	12,240	100	24,580	9.8%	£35.00	£42.23	£77.23	12,340	100	24,580	9.8%			£0.78	£0.78
G	54,320	55,790	-1,470	110,110	44.0%	-£749.70	£189.17	-£560.53	54,320	-1,470	110,110	44.0%			£3.52	£3.52
H	5,690	4,450	1,240	10,140	4.0%	£434.00	£17.42	£451.42	5,690	1,240	10,140	4.0%			£0.32	£0.32
Totals	**125,260**	**125,260**	**0**	**250,520**	**100.0%**	**-£430.40**	**£430.40**	**£0.00**	**125,260**	**0**	**250,520**	**100.0%**		**-£8.00**	**£8.00**	**£0.00**

^ Neutrality 'residue' - refunded to shippers

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SMP(b)	0.51 DSMP
SAP	0.50
SMP(s)	0.35 SO Sell Trade

A,B,C **15,330**

15,330

Negative imbalance represents a Shipper who was short, and negative User costs are therefore credits to the SO (debit to the Shipper)
Positive imbalance represents a Shipper who was long, and positive User costs are therefore debits to the SO (credit to the Shipper)