



UNC Workgroup Report	At what stage is this document in the process?
<p><b>UNC 0636 0636A</b>  <b>0636B 0636C:</b>  <b>Updating the parameters for the NTS Optional Commodity Charge</b></p>	<p>01 Modification  02 Workgroup Report  03 Draft Modification Report  04 Final Modification Report</p>
<p><b>Purpose of Modification:</b></p> <p>To update the parameters used in the derivation of the Optional Commodity Charge tariff in order to reduce the current level of effective cross subsidy by gas customers who cannot avail of the Optional Commodity Charge.</p> <p>To update the parameters used in the derivation of the Optional Commodity Charge tariff in order to limit the distance against which Users may apply the Optional Commodity Charge.</p> <p>To update the parameters used in the derivation of the Optional Commodity Charge tariff with RPI.</p> <p>To update the parameters used in the derivation of the Optional Commodity Charge tariff but with the provision for an exemption for interconnector points from the updated parameters used in the derivation of the OCC until an enduring solution recognising the European Tariff Network Code requirements have been implemented.</p>	
	<p>The Workgroup recommends that this modification should be:</p> <ul style="list-style-type: none"> <li>considered a material change and not subject to self-governance</li> <li>proceed to Consultation</li> </ul> <p>The Panel will consider this Workgroup Report on <b>15 March 2018</b>. The Panel will consider the recommendations and determine the appropriate next steps.</p>
	<p><b>High Impact:</b></p> <p>Users opting for the Optional Commodity Charge could expect an increase in the tariff.</p> <p>Users opting for the Optional Commodity Charge will no longer be able to benefit as much as the existing formula from the OCC following implementation.</p> <p>Users opting for the Optional Commodity Charge could expect an increase in the tariff but these changes would not apply to interconnector points until an enduring solution is implemented that recognises the European Tariff Network Code requirements.</p> <p>Note that it is expected that the tariff would still be available as an option to avoid inefficient bypass of the NTS.</p> <p>Users opting for the Optional Commodity Charge for longer distances will no longer be able to benefit from the OCC following implementation.</p> <p>The Standard Commodity tariff would be consequentially reduced under all proposals.</p>

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Timetable		
<b>Modification timetable:</b>		
Initial consideration by Workgroup	06 November 2017	
Workgroup Report presented to Panel	19 April 2018	
Draft Modification Report issued for consultation	19 April 2018	
Consultation Close-out for representations	11 May 2018	
Final Modification Report available for Panel	14 May 2018	
Modification Panel decision	17 May 2018 ( <i>short notice</i> )	
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## 1 Summary

### What

The NTS Optional Commodity Charge (OCC) was introduced in 1998 and the tariff has not been updated for nearly 20 years. Therefore, it is proposed that the parameters within the NTS OCC formula need to be updated to be more reflective of the current costs and pipeline utilisation.

### Why

The OCC was introduced in 1998 with the express intention of providing a mitigating option for shippers seeking short distance transportation, and was justified on the basis of avoiding inefficient bypass of the NTS. Given that the tariff has not been updated in nearly 20 years whilst standard commodity charges have risen significantly over the same period, the OCC has become a very attractive option even for exit points that are increasingly distant from an associated entry point.

National Grid NTS have advised the NTSCMF1 that Users opting to avail of the OCC during the current Gas Year (17/18) will pay an estimated £48.5 million in optional commodity charges but, in doing so, will avoid paying nearly £195 million in standard commodity charges.

This represents a potential cross-subsidy to those OCC Users of about £146 million per annum at the expense of those sites which are unable to benefit from the option of the OCC.

This proposal would update the OCC tariff formula as proposed in Modification 0636 but it would exempt all Interconnector Points (Entry and Exit) ("IPs") from these changes on the following grounds:

- Requires an enduring solution that recognises the European Tariff Network Code requirements that would allow adequate consideration by all relevant parties, avoids short-term disruption, is more rational and was foreseen previously under GCD11<sup>2</sup>.
- Such a process is expected to be delivered under Modification 0621.
- IPs, would be exempted from the proposed changes to the parameters used in the derivation of the OCC tariff until this solution is implemented and this approach would mitigate any potential impacts in neighbouring markets, including security of supply.

### How

It is therefore proposed to give effect to this modification by way of two changes to the UNC TPD, Section Y paragraph 3.5 "NTS Optional Commodity Rate".

1. Replace the current formula with that proposed in 2015 as Option 2 by National Grid in its discussion document NTS GCD11<sup>3</sup>.

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<sup>1</sup> NTSCMF 26 September 2017

<sup>2</sup> <https://www.nationalgrid.com/uk/gas/charging-and-methodologies>

<sup>3</sup> <http://www2.nationalgrid.com/UK/Industry-information/System-charges/Gas-transmission/Charging-methodology/Gas-Charging-Discussion-papers/>

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2. Adjust the assumed capacity of the alternative by-pass pipeline against which the OCC charges are calculated. Specifically replace the MNEPOR in the current formula with the average daily flow at the exit point from the previous Gas Year divided by 75%.

It is proposed that the changes arising from this code modification be implemented by 01 April 2018 thereby saving up to £220<sup>4</sup> million in cross subsidies relative to the base case of waiting until October 2019<sup>5</sup>.

It is proposed to give effect to this modification by way of a single change to the UNC TPD, Section Y paragraph 3.5 "NTS Optional Commodity Rate".

Introduction of a distance cap, which will be applied in the application of the term "D" in the NTS Optional Commodity Charge Rate formula. Where the distance from the relevant offtake and the specified entry point exceeds this cap, the Optional Commodity Rate cannot be applied. It is proposed that the distance cap is set at 115km.

It is proposed that the changes arising from this code modification be implemented on 01 October 2018.

It is proposed to give effect to this modification by way of a single change to the UNC TPD, Section Y paragraph 3.5 "NTS Optional Commodity Rate" and the insertion of a methodology into the same Section Y.

Updating of the cost components of the NTS Optional Commodity Charge Rate formula by indexing to RPI.

It is proposed that the changes arising from this code modification be implemented by 01 April 2018 (if possible).

All Interconnector Points to be exempt from these changes until an enduring solution recognising the European Tariff Network Code requirements is implemented as anticipated under Modification Proposal 0621

## 2 Governance

### Justification for Authority Direction

National Grid NTS have advised the NTSCMF<sup>6</sup> that Users opting to avail of the OCC during the current Gas Year (17/18) will pay an estimated £48.5 million in optional commodity charges but, in doing so, will avoid paying nearly £195 million in standard commodity charges. This represents a potential cross-subsidy to those OCC Users of about £146 million per annum at the expense of those sites which are unable to benefit from the option of the OCC. It is proposed that the changes arising from this code

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<sup>4</sup> This value assumes an equal load profile throughout the Gas Year.

<sup>5</sup> It is anticipated that Modification Proposal 0621 will propose changes to the Optional Commodity tariff for implementation from October 2019 for compliance with the EU Tariff Code.

<sup>6</sup> NTSCMF 26 September 2017

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modification be implemented by 1 October 2018 thereby saving up to £220<sup>7</sup> million in cross subsidies relative to the base case of waiting until October 2019<sup>8</sup>.

This Modification should be considered likely to have a material on competition in, or commercial activities related to, the shipping, transportation or supply of gas. It therefore should be sent to the Authority for decision.

### Requested Next Steps

This modification should:

- be considered a material change and not subject to self-governance; and
- proceed to Consultation

Workgroup participants agreed that the report was suitable for consultation and direction by the Authority.

## 3 Why Change?

The parameters within the NTS Optional Commodity Charge (OCC) formula need to be updated to be more reflective of the current costs and pipeline utilisation.

The OCC is available as an alternative (instead of the Standard Commodity Charges) to Users nominating a “point to point” path for transportation from an NTS entry point to an NTS offtake point. If a User elects for the OCC, all NTS Entry and Exit (SO & TO) Commodity Charges are avoided. The NTS OCC is derived from the estimated cost of laying and operating a dedicated pipeline of NTS specification. This is defined in UNC TPD Section Y. The OCC was introduced in 1998 with the express intention of providing a mitigating option for shippers seeking short distance transportation, and was justified on the basis of avoiding inefficient bypass of the NTS.

0636B - Given that the tariff has not been updated in nearly 20 years it is appropriate to adjust the cost components to ensure compliance with the Relevant Charging Methodology Objectives.

Given that the tariff has not been updated in nearly 20 years whilst standard commodity charges have risen significantly over the same period, the OCC has become a very attractive option even for exit points that are increasingly distant from an associated entry point. The parameters on which the OCC tariff is predicated are no longer considered to be appropriate as

1. The formula used to calculate the current Optional Commodity rates uses the costs of building and operating a dedicated pipeline at the time of introduction in 1998<sup>9</sup> and has not been amended since. The Transco Consultation Report on PC9A (December 1997) provided the opportunity to

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<sup>7</sup> This value assumes an equal load profile throughout the Gas Year.

<sup>8</sup> It is anticipated that Modification 0621 will propose changes to the Optional Commodity tariff for implementation from October 2019 for compliance with the EU Tariff Code.

<sup>9</sup> Using 1997 construction and operational costs, annuitized over a ten year project life using a 10% project discount rate.

update the costs although this has, so far, not been effected.<sup>10</sup> National Grid sought to update the cost inputs in 2015. While Code Modification 0563S facilitated the inclusion of the formula into the UNC TPD, Section Y from the NTS Transportation Statement, the update to the original OCC formula is still outstanding as National Grid decided to wait until there was more clarity on the EU Tariff Code rather than any suggestion that it was inappropriate to update the charging formula.

2. Load factors at exit points are very low in relation to the design capacity assumption embedded within the OCC charge – nowhere near the 75% assumption, meaning that the OCC is too low. National Grid NTS advised at a recent NTSCMF (17 July) that the average load factor of short-hauled gas has declined to about 20% during the 16/17 Gas Year.

National Grid NTS have advised the NTSCMF<sup>11</sup> that Users opting to avail of the OCC during the current Gas Year (17/18) will pay an estimated £48.5 million in optional commodity charges but, in doing so, will avoid paying nearly £195 million in standard commodity charges. This represents a potential cross-subsidy to those OCC Users of about £146 million per annum at the expense of those sites which are unable to benefit from the option of the OCC.

1. Users opting for the OCC during the current Gas Year will pay an estimated £48.5 million in optional commodity charges but, in doing so, will avoid paying nearly £195 million in standard commodity charges. This represents a potential cross-subsidy to those OCC Users of about £146 million per annum at the expense of those sites unable to benefit from the option of the OCC.
2. The proposal requires a change to the charging methodology contained within Section Y of the UNC and Section B3.12.10 (b).
3. If the change is not made there will be up to £220 million in cross subsidies by Users unable to benefit from the OCC (largely within the Distribution Networks) in the interim period between April 2018 and October 2019 before Modification 0621 could be expected to address the issue.

The proposer is aware that National Grid is planning to address this cross-subsidisation from October 2019 as part of Modification 0621 but is concerned that this will not address the on-going cross-subsidisation in the interim. The proposer doesn't wish to burden National Grid unduly in the administration of an amended OCC and also appreciates the need to develop a fairly simple solution that can be implemented relatively quickly and which will materially address the cross-subsidisation in the period to October 2019. Use of "Option 2" as proposed by National Grid in its discussion document NTS GCD11<sup>12</sup>.

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**Secondly, in the interests of keeping the level of the tariff in line with current pipeline costs, we propose that the function should be reviewed at the same time as the annual review of general transportation charges, and updated in line with a suitable escalator.**

<sup>11</sup> NTSCMF 26 September 2017

<sup>12</sup> <http://www2.nationalgrid.com/UK/Industry-information/System-charges/Gas-transmission/Charging-methodology/Gas-Charging-Discussion-papers/>

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1. This Modification is seeking to use pipes that are more reflective of those that may be built as alternatives to the NTS and to use more up-to-date costs that would be more cost reflective.
2. This proposal proposes the use of Option 2 as detailed by National Grid in 2015 in its discussion document NTS GCD11. In summary, this option retains the underlying assumptions of the current OCC charge and maintains the same structure in the formula. The update inflates the current portfolio of unit costs using publicly available indices and also adds in those larger pipe sizes for which National Grid received target efficient unit costs. The application of a combination of steel and RPI indices are applied so as to result in a consistent set of cost data. The topic was discussed during NTSCMF meetings leading up to the GCD11 paper and has been further discussed as part of the wider charging review in 2017. Alternative cost data for pipe building has been requested as part of both these processes. The response has been limited potentially because of commercial confidentiality. The data underlying Option 2 therefore represents a pragmatic estimate to facilitate the calculation of an OCC rate that could be applied across all distances and load sizes.
3. The following is an extract from NTS GCD11 listing the steps NG used in the derivation of the original "short-haul" tariff and their review as detailed in NTS GCD11.

The NTS Optional Commodity charge function was produced using the following steps:

- a) Uses a pipeline portfolio that, through using flow rates and distances, allocates a specific pipe size from the portfolio to a certain distance and flow rate combination;
- b) Produce a cost for each distance/flow rate combination by using a fixed element, relating only to the pipe diameter (this can be thought of as the "connection cost" to the NTS) and a distance related (cost per km) element which applies to a range of pipe diameters;
- c) Produce an annual capital cost based on an annuity period of 10 years;
- d) Produce commoditised unit costs (in terms of p/kWh) determined assuming a standard 75% load factor.
- e) Measure the average p/kWh using a comparison between the costs at 0km and 50km.

### 0636A

1. The proposal requires a change to the OCC charging formula contained within Section Y of the UNC).
2. If the change is not made there will be up to £195 million in charges transferred to Users unable to benefit from the OCC (largely within the Distribution Networks) in the period between October 2018 and October 2019.

The proposer is aware that National Grid is planning to address this transfer of costs from October 2019 as part of Modification 0621. It is expected that this proposal will be replaced by the OCC arrangements set out on Modification 0621 or any of its alternatives. The inclusion of a distance cap in the OCC formula will remove any routes which exceed this distance from operating under the OCC.

The distance of 115 km has been selected on the basis of the analysis provided by National Grid to NTS Charging Methodology Forum on 6 May 2015. It reported that if the top 25% of OCC users (by distance) were not on OCC, and on a recalculated normal commodity rate, the revenue from that group would increase from £14m to £71m and revenue from shippers not on OCC would decrease from £624m to £569m. Since this meeting National Grid has informed the proposer that the average distance (in terms of route) of the top 25% (by distance) of OCC users is 115 km (based on April 2014 flows).

### 0636C

However, all Interconnector Points (entry and exit) should be exempted from the changes to the derivation of the OCC on the following grounds:

- GCD11 foresaw that methodology change to the charging system in order to comply with the EU Regulation TAR would impact the OCC. It concluded that a review and any change to the OCC should take place at a later date with the intention to produce an enduring, compliant solution. Such a process is taking place under Modification UNC 0621 with the recommended solution being subject to a full review by ACER, neighbouring NRAs and other interested parties via consultation (subject to Brexit transitional arrangements being agreed), as prescribed under TAR.<sup>13</sup>
- While TAR compliance is not required until October 2019, the Regulation has been in place since April 2017 and most of the gas markets have already taken steps to adjust charging methodologies in line with TAR. As the TAR content and required process is published and known, it would be prudent to take it into account when making any changes to the charging system in order to avoid unnecessary disruption and inefficiency (i.e. due to an interim change, followed by a transition phase to the enduring solution).

This approach to minimise duplication of work was recognised by Ofgem in its consultation<sup>14</sup> on proposals to implement aspects of the Regulation (EU) 2017/460, the European Network Code on harmonised transmission tariff structures for gas (TAR NC) which closed on 6 November 2017 and is awaiting a decision.

In the consultation, Ofgem proposed to align the stakeholder consultations required for UNC0621 and TAR NC by using a single consultation document that satisfies the requirements of both. Ofgem's proposal is

*"...to facilitate alignment of the consultation processes, we propose that the UNC0621 industry consultation, which is required under UNC modification rules, and the extended final article 26 consultation, are carried out using a single consultation document. We propose that this document shall be the UNC0621 draft modification report ("DMR"), including any alternative modification proposals that may arise."*

Ofgem published its Decision on 8<sup>th</sup> March 2018<sup>15</sup> in which they directed National Grid Gas plc (NGG) to undertake specific tasks which arise under TAR NC.

By Ofgem extending the scope of UNC 0621 to include the matters required under TAR NC, the impact of changes to the OCC tariff on all IPs would be addressed under UNC 0621 and therefore IPs should be exempt from any changes to the OCC tariff until a decision is made and implemented under UNC 0621.

- Modification UNC 0621 discussions include transitional arrangements to avoid step change impacts on Shippers and consumers. No transitional arrangements for interconnector points exist under the proposed UNC 0636 Modification or any of the alternatives which conflicts with Ofgem's Decision to direct NGG to undertake specific tasks which arise under TAR NC. In consideration specifically of the Moffat exit point, which is critical for security of supply to the island of Ireland, an isolated gas system, considerable material impact will be caused by the changes suggested under this proposal. Approval of Modification UNC 0621 is subject to neighbouring NRA involvement under TAR NC as part of the enduring methodology change. The short-term disruptive impact of UNC 0636 to security of supply to Ireland will not be fully assessed or understood in the timescale

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<sup>13</sup> Regulation (EU) 2017/460 of 16 March 2017 establishing a network code on harmonised transmission tariff structures for gas, Art. 26 - 28.

<sup>14</sup> <https://www.ofgem.gov.uk/publications-and-updates/consultation-proposals-implement-aspects-regulation-eu-2017460-european-network-code-harmonised-transmission-tariff-structures-gas-tar-nc>

<sup>15</sup> Decision to direct National Grid Gas plc (NGG) to undertake specific tasks to implement aspects of Regulation (EU) 2017/460, the European Network Code on harmonised transmission tariff structures for gas (TAR NC).



and process available. TAR NC permits differential treatment of IPs as an homogenous group of points used for a specific purpose, and further differential treatment of IPs to and from isolated gas networks, for security of supply purposes.<sup>16</sup>

## 4 Code Specific Matters

### Reference Documents

1. The Statement of Gas Transmission Transportation Charges  
<https://www.gasgovernance.co.uk/sites/default/files/ggf/book/2017-09/Transportation%20statement%20October%2017%20.pdf>
2. Proposed Modification UNC 0621
3. Ofgem Decision to direct National Grid Gas plc (NGG) to undertake specific tasks to implement aspects of Regulation (EU) 2017/460, the European Network Code on harmonised transmission tariff structures for gas (TAR NC)

### Knowledge/Skills

Understanding of the NTS charging methodology in respect of the Optional Commodity Charge.

## 5 Solution

### 0636 - Updating the parameters for the NTS Optional Commodity Charge

The proposal requires a change to the charging methodology contained within Section Y (3.5 NTS Optional Commodity Rate) and Section B3.12.10(b) of the UNC.

The parameters of the NTS Optional Commodity charge formula are derived from flow rates, pipeline distances and underlying costs. The current formula is as follows:

$$p/kWh = 1203 \times M^{-0.834} \times D + 363 \times M^{-0.654}$$

Where:

D is the direct distance of the site or non-National Grid NTS Pipeline to the elected Entry Terminal

M is the Maximum NTS Exit Point Offtake Rate (MNEPOR) at the site, converted into kWh/day

^ means 'to the power of..'

The proposed formula is as follows:

$$p/kWh = 1247 \times M^{-0.78} \times D + 1422 \times M^{-0.708}$$

Where:

D is the direct distance of the site or non-National Grid NTS Pipeline to the elected Entry Terminal

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<sup>16</sup> For example, Preamble (5) and Art. 9.2.

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M is the aggregate of the allocated daily energy in kWh/day at the exit point from the previous Gas Year divided by the number of days in the previous Gas Year and further divided by 75% except:

- (i) where the site is new and hence there is no flow history, retain the existing formula for M of 24 times the Maximum NTS Exit Point Offtake Rate
- (ii) for an NTS Exit Point in respect of a pipeline interconnector having no physical exit capability, M is the aggregate of the allocated daily energy in kWh/day from the previous Gas Year divided by the number of days in the Gas Year and further divided by 75% to the NTS at the System Entry Point associated with such Connected Delivery Facility.
- (iii) Where M is zero or less M will be deemed to be equal to 1 kWh/day

^ means 'to the power of..'

The update to the parameters would be effective for all sites availing of the OCC from the time of implementation of the Mod and no further updates are envisaged prior to October 2019.

Thereafter, an annual process would update M each April commencing April 2019 for effect from the following October in the event that this Mod is not superseded by code changes necessary for EU TAR compliance.

For the avoidance of doubt:

- (i) At the time of calculation of the charge rates (which will be subject to the 2 months' notice of charges), the average aggregate allocated daily energy will take the latest gas year for which data is available – For example implementation anytime between 1 April and 1 October 18 will use data from the Gas Year October 16 to September 17.
- (ii)  $M = (\sum E) / N \times 100 / 75$  where E is the allocated daily energy for each day of the relevant Gas Year at the exit point and N is the number of days in the relevant Gas Year
- (iii) The 75% divisor converts an annual daily load to a notional peak day load which determines an appropriate pipe building cost estimate which is then used to derive the unit rate. The value of 75% is consistent with the assumption embedded in the current OCC formula.
- (iv) A new site ceases to be new if at the annual update it has at least a full Gas Year's allocation history (even though some allocations could be zero)
- (v) M for a seasonal site will have its value calculated in the same way as a non-seasonal site and zero allocation values will be included in the calculation of  $\sum E$ .

### 0636A - Updating the parameters for the NTS Optional Commodity Charge

The proposal requires a change to the charging formula contained within Section Y (3.5 NTS Optional Commodity Rate).

The parameters of the NTS Optional Commodity charge formula are derived from flow rates, pipeline distances and underlying costs. The current formula is as follows:

$$p/kWh = 1203 \times M^{-0.834} \times D + 363 \times M^{-0.654}$$

Where:

D is the direct distance of the site or non-National Grid NTS Pipeline to the elected Entry Terminal

M is the Maximum NTS Exit Point Offtake Rate (MNEPOR) at the site, converted into kWh/day

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^ means 'to the power of.'

The proposed change to the formula is to insert a distance cap in relation to the D function of 115 km. as follows:

$$p/kWh = 1203 \times M^{-0.834} \times D + 363 \times M^{-0.654}$$

Where:

D is the direct distance of the site or non-National Grid NTS Pipeline to the elected Entry Terminal, where D must be equal to or less than 115 km

M is the Maximum NTS Exit Point Offtake Rate (MNEPOR) at the site, converted into kWh/day

^ means 'to the power of.'

The update to the definition of D would be effective for all sites availing of the OCC from the time of the effective date of the Mod.

### Interim phase

Following receipt of the ROM proposal, it is apparent that the full system solution cannot be delivered on the effective date of this proposal. On this basis, a workaround transition has been developed to ensure the new OCC arrangements can be implemented without disruption to Users. The following sets out some rules to be applied, in the event that the modification proposal is directed for implementation prior to the delivery of a fully automated solution.

1. A minimum of 2 months prior to the effective date of the change, National Grid will write to all Users registered at the relevant Supply Points that the application of the OCC will not be valid from the implementation date (where the relevant Supply Points are those points which are greater than 115km from the nominated Entry Point and subject to the OCC)
2. Users will be instructed to withdraw the Supply Points from the OCC and re-register as the Registered User in accordance with UNC Section B2. The Supply Point Offer made by the CDSP in this instance will reflect non-OCC charges. Registered "ownership" of the Supply Point under non-OCC terms will commence on the effective date of this modification proposal
3. National Grid will monitor the deployment of OCC on a daily basis on the day after each Gas Day commencing on D+1, where D is the effective date of this Modification Proposal:
  - a. The CDSP will provide National Grid with a daily report setting out those sites which are subject to OCC rates and the distances pertaining to each designated route. This will be provided on D+1.
  - b. National Grid will identify any sites where the Distance exceeds 115km and therefore, non-compliant with the application of the OCC
4. For those Supply Points which are non-compliant, National Grid, in conjunction with the CDSP will withdraw the OCC and re-register as Supply Points subject to the standard transportation charges.
5. National Grid will write to those registered Users which have been impacted by Step 4 and removed from the OCC rates.

### 0636B - Updating the parameters for the NTS Optional Commodity Charge

The proposal requires a change to the charging formula contained within Section Y (3.5 NTS Optional Commodity Rate).

The parameters of the NTS Optional Commodity charge formula are derived from flow rates, pipeline distances and underlying costs. The **current** formula is as follows:

$$p/kWh = 1203 \times M^{-0.834} \times D + 363 \times M^{-0.654}$$

Where:

D is the direct distance of the site or non-National Grid NTS Pipeline to the elected Entry Terminal

M is the Maximum NTS Exit Point Offtake Rate (MNEPOR) at the site, converted into kWh/day

^ means 'to the power of..'

The method of determining the NTS Optional Charge for the relevant years will be to follow the following formula structure and indexation approach to provide an updated formula to be applicable in the relevant year. The formula is designed to take into account the estimated costs of laying and operating a dedicated pipeline of an appropriate specification and also takes into account a range of flow rates and pipeline distances.

The **proposed change** to the formula is as follows:

$$p/kWh = w \times (M^x) \times D + y \times (M^z)$$

where:

w means a value derived from the estimated costs (of laying and operating a dedicated pipeline of NTS specification) between the relevant points and the latest indicative value for the 12 month period commencing 01 October 2018 is equal to 2077;

M means the Maximum NTS Exit Point Offtake Rate (MNEPOR) converted into kWh/day at the site as specified in the relevant Network Exit Agreement;

x means a value derived from the estimated costs (of laying and operating a dedicated pipeline of NTS specification) between the relevant points and the latest indicative value for the 12 month period commencing 01 October 2018 is equal to -0.835;

D means the direct ('as the crow flies') distance from the site or non-National Grid NTS pipeline to the Specified Entry Point in km;

y means a value derived from the estimated costs (of laying and operating a dedicated pipeline of NTS specification) between the relevant points and the latest indicative value for the 12 month period commencing 01 October 2018 is equal to 608;

z means a value derived from the estimated costs (of laying and operating a dedicated pipeline of NTS specification) between the relevant points and the latest indicative value for the 12 month period commencing 01 October 2018 is equal to -0.654;

and ^ means to the power of Indexation.

For each year of application, the arithmetic average monthly RPI value for the previous formula year will be used to index the cost base used to derive these values. The values specified are based on RPI data available to date in the current formula year (April 2017 to January 2018).

#### Indexation Approach

It is proposed that the estimated costs (of laying and operating a dedicated pipeline of NTS specification) which underpin the calculation that derives the values w, x, y and z above are subject to indexation to the Retail Prices Index (RPI) for the relevant charge period consistent with RIIO-T1 Licence RPI calculations. The cost base will be updated using publicly published RPI figures from the previous completed formula year (i.e. October 2019 will be updated using April 2018 to March 2019 data) and the formula for determine the RPI will be as follows:

$$RPI_t = RPI_{t-1} / RPI_{1998/99}$$

$RPI_t$  means the arithmetic average of the monthly Retail Price Index published or determined with respect to each of the twelve months from 1 April to 31 March in formula Year t.

It is proposed that the NTS Optional Charge rate (in place for an individual Supply Point Registration) will be subject to change annually (as a consequence of the indexation described above).

The methodology that supports the derivation of the above formula and its parameters will be included in a separate Methodology Statement.

Note: it is intended that the Methodology Statement will be presented to Panel at the same time as completion of the Draft Workgroup Report. This will provide transparency as required under EU regulation. Creation of a Methodology Statement is seen as a more pragmatic way of achieving transparency than insertion into the UNC given the significant legal interpretation required with the latter approach.

### 0636C - Updating the parameters for the NTS Optional Commodity Charge

The proposal requires a change to the charging formula contained within Section Y (3.5 NTS Optional Commodity Rate).

The parameters of the NTS Optional Commodity charge formula are derived from flow rates, pipeline distances and underlying costs. The **current** formula is as follows:

$$p/kWh = 1203 \times M^{-0.834} \times D + 363 \times M^{-0.654}$$

Where:

D is the direct distance of the site or non-National Grid NTS Pipeline to the elected Entry Terminal

M is the Maximum NTS Exit Point Offtake Rate (MNEPOR) at the site, converted into kWh/day

^ means 'to the power of..'

The **proposed** change to the formula is as follows:

$$p/kWh = 1247 \times M^{-0.78} \times D + 1422 \times M^{-0.708}$$

Where:

D is the direct distance of the site or non-National Grid NTS Pipeline to the elected Entry Terminal.

M is the aggregate of the allocated daily energy in kWh/day at the exit point from the previous Gas Year divided by the number of days in the previous Gas Year and further divided by 75% except:

- (i) where the site is new and hence there is no flow history, retain the existing formula for M of 24 times the Maximum NTS Exit Point Offtake Rate
- (ii) for an NTS Exit Point in respect of a pipeline interconnector having no physical exit capability, M is the aggregate of the allocated daily energy in kWh/day from the previous Gas Year divided by the number of days in the Gas Year and further divided by 75% to the NTS at the System Entry Point associated with such Connected Delivery Facility.
- (iii) Where M is zero or less M will be deemed to be equal to 1 kWh/day

^ means 'to the power of'.

The update to the parameters would be effective for all sites availing of the OCC from the time of implementation of the Mod and no further updates are envisaged prior to October 2019.

Thereafter, an annual process would update M each April commencing April 2019 for effect from the following October in the event that this Mod is not superseded by code changes necessary for EU TAR compliance.

For the avoidance of doubt:

- (i) At the time of calculation of the charge rates (which will be subject to the 2 months' notice of charges), the average aggregate allocated daily energy will take the latest gas year for which data is available – For example implementation anytime between 1 April and 1 October 18 will use data from the Gas Year October 16 to September 17.
- (ii)  $M = (\sum E) / N \times 100 / 75$  where E is the allocated daily energy for each day of the relevant Gas Year at the exit point and N is the number of days in the relevant Gas Year
- (iii) The 75% divisor converts an annual daily load to a notional peak day load which determines an appropriate pipe building cost estimate which is then used to derive the unit rate. The value of 75% is consistent with the assumption embedded in the current OCC formula.
- (iv) A new site ceases to be new if at the annual update it has at least a full Gas Year's allocation history (even though some allocations could be zero)
- (v) M for a seasonal site will have its value calculated in the same way as a non-seasonal site and zero allocation values will be included in the calculation of  $\sum E$ .

**Where an OCC route contains an Interconnector Point (either entry or exit) it will continue to use the current formula ( $p/kWh = 1203 \times M^{-0.834} \times D + 363 \times M^{-0.654}$ ) and will be exempt from the change to the formula as outlined above.**

**For avoidance of doubt:**

- **the revised rate as proposed would only apply where both the entry and exit point are Non IPs.**
- **no changes are being proposed to the current application process for the OCC.**

## 6 Impacts & Other Considerations

### Does this modification impact a Significant Code Review (SCR) or other significant industry change projects, if so, how?

There is no impact on an SCR. The proposer believes there is no impact on the current charging review that is due for implementation in 2019 for compliance with the EU Tariff Code. However, short haul/OCC for the longer term is being considered as part of the NTS Charging Review/Modification 0621.

### Consumer Impacts

The following is a summary of the workgroup assessment and it is included here to complete this consumer impacts section. The reader is recommended to read the workgroup assessment below for full details of the analysis conducted and the views of the workgroup. The workgroup recommends that Ofgem conduct a Regulatory Impact Assessment<sup>17</sup> on this proposal and their representative has confirmed that they are minded to do so.

If implemented, the modification will lead to a redistribution of transportation costs amongst the shippers:

- An increase in costs by those shippers that are currently using the OCC
- A reduction in costs by those shippers that are currently using the Standard Commodity Charge

The impacts of the above redistribution of costs are summarised below.

#### A reduction in costs by those that are currently using the Standard Commodity Charge

The proposer stated that the information provided during the development of Modification 0621 (raised by National Grid NTS) included an analysis of the level of the redistribution of transportation costs arising through the current OCC.

The Proposer has analysed this data to determine the impacts, including those on consumers. The Standard Commodity charges are estimated to fall by 15% as a larger proportion of flows will be applicable to these charges rather than the OCC. It is expected that consumers within the distribution networks and sites directly connected to the NTS which are currently not availing of the OCC will see corresponding reductions in charges in due course (assuming flows on the system do not change).

### Consumer Impact Assessment

*(Workgroup assessment of proposer initial view or subsequent information)*

Criteria	Extent of Impact
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<sup>17</sup> The basic timeframe for an RIA is circa 8 weeks for a non-urgent modification, or circa 4 weeks for urgent modifications, with Ofgem consideration commencing when the Draft Modification Report is formally issued to consultation (for no less than 15 business days) by Panel which is then followed up by an 8 week RIA consultation following publication of the Final Modification Report. <https://www.ofgem.gov.uk/publications-and-updates/impact-assessment-guidance>

Which Consumer groups are affected?	A reduction in costs could be seen by those shippers supplying consumers connected to the NTS or Distribution Networks that are currently incurring charges based on the standard commodity rates. It is assumed that these savings will be passed on to these consumers.
What costs or benefits will pass through to them?	<p>The load analysis conducted for 0636 suggests the following potential savings (approx.) could be passed on to customers through a 15% reduction in the standard Commodity charge (per annum):</p> <ul style="list-style-type: none"> <li>• Domestic Consumers - £1 to £3</li> <li>• Small non-domestic Consumers - £11</li> <li>• Large non-domestic Consumers - £40 to £4K</li> <li>• Very Large Consumers - £40K to £160K</li> </ul> <p>For 0636A the overall reduction in the amount "re-distributed" is £36.5m compared to £82m for 0636. Therefore, the estimated savings for 0636A is around 45% of the above.</p> <p>For 0636B the overall reduction in the amount "re-distributed" is £12.8m compared to £82m for 0636. Therefore, the estimated savings for 0636B is around 16% of the above.</p> <p>For 0636C the overall reduction in the amount "re-distributed" is £Xm compared to £82m for 0636. Therefore, the estimated savings for 0636B is around X% of the above.</p> <p>[to be updated following receipt of 0636C Analysis]</p>
When will these costs/benefits impact upon consumers?	The above benefits could be seen from the date the new commodity rates are applied on an annual basis (assuming these are passed on at the same time to consumers). It was noted by some workgroup members that any part year benefit may not be passed on, as any contract would likely to be in place until the end of the relevant gas year.
Are there any other Consumer Impacts?	See below for details of the impacts on the customers of those shippers that are currently using the OCC.

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**General Market Assumptions as at December 2016 (to underpin the Costs analysis)**

Number of Domestic consumers	21 million
Number of non-domestic consumers <73,200 kWh/annum	500,000
Number of consumers between 73,200 and 732,000 kWh/annum	250,000
Number of very large consumers >732,000 kWh/annum	26,000

**Increase in costs by those that are currently using the OCC**

The savings highlighted above would be offset by increased charges applying to those currently availing of the OCC, namely direct connects within GB and other actors downstream of the interconnectors, including those in other countries.

Some workgroup members felt that the increased OCC could put some of those customers out of business and/or if demand fell on the Interconnection Points (because the price is too high), increased costs could be picked up by consumers.

The Proposer highlighted that no specific detail has been provided to support the risks highlighted by these workgroup members. As the OCC rate will still be available and is still at a very attractive price as



compared to the Standard Commodity charges, the Proposer believes that there will be limited effects in terms of possible changes in flow levels.

Some Workgroup members also felt the proposed timeframe for the adoption of this Modification means that the overall impact on key end users may not be known (consumers may not have time to assess the impact of the Modification on how they operate).

The Proposer believes the timeframe for this Modification allows for indicative and actual charges to be provided with the usual Licence notice periods of 5 and 2 months respectively. The actual date of implementation would also be determined by Ofgem following the UNC Consultation.

### Consumer Impact Assessment

*(Workgroup assessment of proposer initial view or subsequent information)*

Criteria	Extent of Impact
Which Consumer groups are affected?	The above cost savings could be offset by an increase in costs to those shippers connected to the NTS that are currently incurring charges based on the OCC. It is assumed that these costs will be passed on to their customers; NTS direct connects within GB and other actors downstream of the interconnectors, including those in other countries.
What costs or benefits will pass through to them?	<p>The analysis conducted suggests the following potential increases (approx.) to Shippers that could then be passed on to consumers:</p> <ul style="list-style-type: none"> <li>Very Large Consumers – currently 49 contracted routes (45 Exit Points, including interconnectors) that utilise the OCC and the analysis conducted implies that this would reduce to 27 under 0636, 38 for 0636A, 47 for 0636B and X for 0636C.</li> <li>The analysis also concludes that Modification 0636 increases the amount charged by £82m (£40.3m for those remaining on OCC and £41.45m for those leaving OCC), Modification 0636A increases the charges (for those leaving OCC) by £49.2m, Modification 0636B increases the charges to those remaining on OCC by £12.6m and Modification 0636C [redacted] [to be updated following receipt of 0636C Analysis]</li> </ul>
When will these costs/benefits impact upon consumers?	The above increase could be seen from the date the new commodity rates are applied on an annual basis (assuming these are passed on at the same time to consumers). It was noted by some workgroup members that any part year cost may not be passed on, as any contract would likely to be in place until the end of the relevant gas year.
Are there any other Consumer Impacts?	See above for details of the potential benefits to those consumers whose shippers are currently incurring charges based on the standard commodity rates.

#### General Market Assumptions as at December 2016 (to underpin the Costs analysis)

Number of Domestic consumers	21 million
Number of non-domestic consumers <73,200 kWh/annum	500,000
Number of consumers between 73,200 and 732,000 kWh/annum	250,000
Number of very large consumers >732,000 kWh/annum	26,000

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## Cross Code Impacts

There is no impact expected.

## EU Code Impacts

None – this change is for the interim period until the charging review is implemented in 2019 for compliance with the EU Tariff Network Code. The proposer anticipates that the wider charging review will include a more comprehensive update of the OCC.

However, should the OCC remain unchanged as part of the charging methodology under the Modification 621 Proposals, compliance with the TAR Code will need to be checked. The interactions between Modifications 0636 and 0621 are covered further in the workgroup assessment section of this report.

## Central Systems Impacts

See section 6 of the workgroup impact assessment for details of the implementation costs and system impacts.

## Workgroup Impact Assessment

### [Summary of Workgroup Impact Assessment](#)

The Workgroup sought clarification of several matters referred from Panel, identified within initial representations (submitted by Gazprom, Petronas and Energy UK) and relating to this change proposal. These can be summarised as below:

- Understanding the objective
- Consider the links, relationship and impacts with the relevant elements of modification 0621 – Amendments to Gas Transmission Charging Regime.
- Assessment of alternative means to achieve objective
- Development of Solution (including business rules if appropriate)
- Assessment of potential impacts of the modification
- Assessment of implementation costs
- Assessment of legal text.
- Consider the distance Cap specified in the modification and how many Supply Points are impacted

The workgroup assessment considers each of the above points in turn.

### 1. Understanding the objective

#### [Background and context around GCD11](#)

In July 2015, National Grid NTS published an NTS Gas Charging Discussion Document "NTS GCD11 - Updating the Cost Inputs to the NTS Optional Commodity Charge Function" (GCD11) and the document can be found in Appendix 1 of this report. GCD11 set out for discussion options for updating The Statement of Gas Transmission Transportation Charges, in respect of the NTS Optional Commodity charge (known as the NTS "Shorthaul" rate). The table below includes details of the 2 options.

Options	Option Details
Option One	Using pipe sizes and unit costs that were provided under the RIIO-GT1 Price Control.

<b>Option Two</b>	Updating the current portfolio of unit costs using publicly available indices and including the pipe sizes and unit costs that were provided for under the RIIO-GT1 Price Control.
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The intention was to update the cost inputs and consequently the NTS Optional Commodity charge rate. It was highlighted that all NTS Optional Commodity rates would change as a result of updating the formula and they will apply to all those shippers currently on or who may request the NTS Optional Commodity charge in the future.

The NTS Optional Commodity charging product was introduced in 1998 to seek to avoid inefficient by-pass of the NTS by large sites located near to entry terminals. As the charge is an alternative to investment, the formula to calculate individual NTS Optional Commodity charge rates is derived from an estimated cost of laying and operating a dedicated pipeline of NTS specification (i.e. the estimated cost of by-passing the NTS). Shippers can elect to pay the NTS Optional Commodity charge as an alternative to the NTS SO and TO, Entry and Exit Commodity charges.

Since its introduction in 1998 the function used to calculate the Optional Commodity rates has not been amended and so is based on the costs used in 1998. National Grid's view at the time was that a review of the cost inputs to the NTS Optional Commodity charge function was required.

In December 2015, National Grid NTS published "NTS GCD11R - Updating the Cost Inputs to the NTS Optional Commodity Charge Function" (GCD11R). A copy of GCD11R can be found in in Appendix 2 to this workgroup report. National Grid NTS decided not to proceed with either of the proposed options given under NTS GCD11, to allow the UNC Modification process for UNC 0563S<sup>18</sup> to conclude before making any further proposals for potential changes to the NTS Optional Commodity charge, which could include any EU TAR NC / GTCR impacts or issues.

#### Governance around the current methodology for the OCC

Currently there is no detailed methodology to describe how the NTS Optional Commodity Charge Formula is derived within the UNC. However, it is contained in Charging methodology documentation which preceded the inclusion of Section Y within the UNC. The Proposer believes that this Modification contains sufficient information to support the revised formula.

Note: that the existing formula was included in the UNC as a result of Mod 0563S and was considered robust enough to justify the underlying methodology.

Notwithstanding the above, some workgroup members felt that a standalone methodology was required in the UNC to help Shippers understand how the NTS Optional Commodity Charge Formula is derived.

#### Issues with GCD11 incl. GCD11 Formula not subject to full stakeholder review

Some workgroup members were concerned that the GCD11Formula was not subject to a full stakeholder review. The spreadsheet provided to help industry to understand the derivation of the formula was only published after consultation on GCD11 had closed and includes dummy values.

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<sup>18</sup> UNC Modification 0563S – Moving the NTS Optional Commodity Charge Formula into the UNC (UNC 0563S) was subsequently implemented in January 2016 and moved the existing NTS Optional Commodity charge formula which is specified in the NTS Transportation Charging Statement (The Statement of Gas Transmission Transportation Charges) into TPD Section Y (Charging Methodologies) of the UNC.

The proposer of 0636 has undertaken a thorough review of the spreadsheet provided to support the current underlying methodology and believes it is robust. This spreadsheet is available at <https://www.gasgovernance.co.uk/0636>. In addition, Appendix 5 provides a summary of the steps in the process (in a more compact form) to aid understanding of the methodology.

For sensitivity and transparency of the National Grid cost information, see below regarding pipeline costs. The proposer of 0636 indicated that for the formula to remain credible it must be updated and believes NG have used the best available data in GCD11. Appendix 3 provides a comparison of pipeline construction costs provided during the Modification 0621 Workgroup meetings as part of the recent and ongoing charging review. Those views that have been provided to date are consistent with GCD11 outcomes.

Modification 0636B went a step further and proposed that the methodology that supports the OCC formula and its parameters be included in the UNC. The Workgroup members believed the information to be incorporated was the right level and aided understanding of how the formula was derived.

Pipeline Sizes: Inclusion of larger and smaller sizes

The current NTS Optional Commodity Charge calculation used in determining the formula, was completed based on the pipe sizes available and utilised in 1998 (specific flow rates and diameters are allocated to a specific pipeline size).

Maximum flow in the 1998 formula was 15 mcmd and maximum distance was 50 km. Small pipes were necessary for shorter distances and lower flows. Large pipes are necessary to cater for unlimited distance and 60 mcmd flows. The table below shows the current and proposed portfolio of pipe sizes.

1998 – Original Portfolio (Current)	GCD11 Option Two (proposed)
50 mm	50 mm
100 mm	100 mm
150 mm	150 mm
200 mm	200 mm
300 mm	300 mm
450 mm	450 mm
600 mm	600 mm
	610 mm
	915 mm
	1220 mm <sup>19</sup>

GCD11 highlighted that option 2 reflects the pipes NTS or providers of by-pass pipes would have to construct and these have changed significantly from those anticipated in 1998 as take-up of the OCC has increased.

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<sup>19</sup> Although this pipe-size is one of the three pipe-sizes where costs have been approved as part of the RIIO Price Control and included in Option 2 it is in fact not actually used in the derivation of the formula as it is too large for the assumed maximum flow rate and distance of 50km.

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Some workgroup members felt the costs for pipeline diameters are included when these are far beyond the pipe size that would be required for most sites (CCGT) that would consider by-pass. A 600mm pipe would be more than sufficient for a 2GWe CCGT.

The proposer believes that the pipeline data set used in the regression analysis should be consistent with the range over which the formula is applicable and National Grid NTS confirmed that the pipe sizes were approved as part of RIIO T1.

An Initial Rep also asked the Transparency of Maximum NTS Exit Point Offtake Rate (MNEPOR) values needs to be considered. The Proposer believes there is no lack of transparency, although National Grid NTS do not publish MNEPOR values per site, they are available to the specific Shipper or DN.

### Cost Data

Actual values for costings of three pipe-sizes in GCD11 are commercially sensitive and therefore dummy values are in the Excel spreadsheet supporting GCD11. The consequences of this are that the formula used does not match exactly that derived in the spreadsheet. However, the individual steps in the process are well documented and National Grid NTS are able to share the commercially sensitive material with Ofgem if required.

#### a) Use of Steel Index and RPI (0636 and 0636B)

The three Initial Reps sought for further clarification on the use of the Steel Index (a major cost component of pipelines) and RPI.

The GCD11 report indicates that the steel index is only used to uplift costs from 1998 to 2009/10 and this is consistent with the National Grid Price Control RIIO-GT1. From 2009/10 to 2015/16 RPI has been used similarly for consistency with the RIIO-GT1 approach. In the absence of recent real cost data, the Proposer of 0636 believes this is a pragmatic way to update the costs.

Note: allowed revenues increase with indices derived from the price control. Standard commodity rates increase (assuming stable flows). Shortfalls in capacity revenues are also recovered by standard commodity charges.

Modification 0636B proposes that the estimated costs (of laying and operating a dedicated pipeline of NTS specification) which underpin the formula calculation be subject to indexation to the Retail Prices Index (RPI) for the relevant charge period consistent with RIIO-T1 Licence RPI calculations. The cost base will be updated annually using publicly published RPI figures from the previous completed formula year.

Source <a href="https://www.ons.gov.uk/economy/inflationandpriceindices/timeseries/chaw/mm23">https://www.ons.gov.uk/economy/inflationandpriceindices/timeseries/chaw/mm23</a>												
1998 APR	1998 MAY	1998 JUN	1998 JUL	1998 AUG	1998 SEP	1998 OCT	1998 NOV	1998 DEC	1999 JAN	1999 FEB	1999 MAR	Average
162.6	163.5	163.4	163	163.7	164.4	164.5	164.4	164.4	163.4	163.7	164.1	163.76
2017 APR	2017 MAY	2017 JUN	2017 JUL	2017 AUG	2017 SEP	2017 OCT	2017 NOV	2017 DEC	2018 JAN	2018 FEB	2018 MAR	Average
270.6	271.7	272.3	272.9	274.7	275.1	275.3	275.8	278.1	276.0			274.25
											Indexation Applied	167%

#### b) Cost of Building Pipeline

The workgroup asked if the proposed charge still an appropriate alternative to investment?

The proposer believes the answer is yes but highlighted that there is no long term commitment in terms of recoverable revenue and routes can be switched with a very short notice period. The proposer was also not aware of any Users considering building a by-pass pipe and encouraged any that were to provide the details to National Grid or Ofgem (if details are confidential and could not be provided within this Workgroup Report).

The proposer indicated that the OCC charge should be sufficient to prevent a real threat of by-pass but not so low as to raise accusations of predatory pricing and highlighted that Tranco commented on this in the PC9a Consultation Report at the time of introduction of the OCC:

- “We recognise that, depending on economic circumstances, bypasses may still occur. Indeed if we were to set prices on an individual site basis to prevent all bypasses we might be accused of predatory pricing. The intention of this tariff is to offer an alternative commodity charge which is more cost-reflective than the current NTS charge and can be assessed alongside other options available to users.
- The level of the tariff also reflects the benefits of being connected to the NTS, which users will wish to consider when deciding which option to pursue. Users may of course choose to accept an interruptible supply and hence avoid incurring exit capacity charges.”

## 2. Consider the links, relationship and impacts with the relevant elements of modification 0621 – Amendments to Gas Transmission Charging Regime.

Modification 0636 is intended to be an interim step forward in the period prior to October 2019, as it will update the underlying costs to 2015. There will be no restriction in terms of distance and eligibility for the OCC [but this is a feature of 0636A](#). It will continue to be an optional replacement for both the TO and SO standard commodity charges.

National Grid NTS [had confirmed \(January 2018\)](#) that Modification 0621 will update whatever code is in place at the time. [In March 2018, some workgroup members became concerned that Modification 0621 would become constrained by Modification 0636 as it was unlikely this change would now be implemented before 0621 was issued for consultation. The 0621 workgroup are to ask that the Code Administrator seeks a View from the Authority on the matter \(in accordance with Mod Rule 12.8\) and the Authority could express a View as to how this Modification Proposal should proceed.](#)

[Some workgroup members were also concerned that if Modification 0621 does not propose changes to the OCC, the updated formula will continue to operate at the same levels introduced by 0636. It is currently expected that Modification 0621 will reflect updated underlying costs for the OCC. It is also anticipated that there will be a distance restriction of 60 Km for eligibility for the OCC.](#)

[Some other workgroup members expected National Grid NTS to raise a further proposal in the unlikely event 0621 or none of its Alternatives was implemented, so that the UNC was compliant from May 2019.](#)

Some workgroup members questioned the wisdom of implementing a solution that they believe would not be compliant with aspects of the EU Law changes that came in to force in April 2017 and will need to be fully implemented in May 2019 where the charges would be applicable from October 2019.

Some members contested this view on the grounds that they believe that the proposed 0636 solution places the 'industry' in a better position than it currently occupies and that Modification 0621 (or another National Grid NTS Modification) would ensure a non-compliance position was not faced in October 2019.

A consequential discriminatory/equitable treatment concern was also raised; the new commodity charge at IPs that will come into effect when the EU TAR Code changes are implemented in October 2019 and this will mean that the TO Commodity Charges would still apply at Non IPs creating a potentially different treatment when compared to the IPs.

[A workgroup member felt the Ofgem stance with regards to P229 was relevant and suggested that to be consistent with this decision Ofgem may reject the 0636 Modifications.](#)

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The workgroup sought the views of Ofgem on this matter but Ofgem were not able to offer any confirmed view point or clarification on whether the modifications needed to be compliant or not with the charges that would be applicable from October 2019, and that any views or opinions would only be proposed at the Final Modification Report (FMR) stage.

### 3. Assessment of alternative means to achieve objective

Some Workgroup members felt the current formula for deriving the OCC should remain in place for existing off-takes utilising short-haul; shippers and consumers should not be penalised for having made historical decisions to use the OCC rather than invest in alternative transportation arrangements at historical cost levels.

The proposer believes this would not achieve the objective. There has been no commitment made by Users of the OCC tariff to contribute a level of revenue consistent with the costs of building such alternative pipelines. Analysis of the likely contributions made by OCC users has been provided during recent meetings of NTSCMF which highlights the relatively low contribution to revenue made by OCC Users. Appendix 4 is an extract from a document provided to the NTSCMF which estimates that sites using the OCC pay around 10% of the annuitised capital and operating costs. This is less than 50% of what it would cost just to operate the by-pass pipelines. The introduction of revenue commitments is something that could be considered within the Modification 0621 proposals but is not part of this current 0636 proposal.

### 4. Development of Solution (including business rules if appropriate)

The Proposers of all the Modifications have undertaken minor developments to improve the clarity of the solution during the Workgroup and/or following meetings with National Grid NTS and Xoserve. The Amended Modifications incorporates the clarifications that were necessary.

### 5. Assessment of potential impacts of the modifications

#### Timing of changes to the OCC

Some members of the workgroup highlighted that parties thought OCC would be static until October 2019 as GCD11R indicated that any proposal could consider the EU TAR Network Code and this is due to take affect from this date. Any changes before then could have an impact on investment.

In response, the proposer highlighted that Standard Commodity charges change at least twice a year and capacity charges change on an annual basis. There are many considerations for investment decision making which typically have long lead times and necessarily include suitable scenario analyses, The Workgroup has not been made aware of any current investment decisions that would be impacted in the period prior to 2019.

On the subject of Interconnectors, one Workgroup member stated that the current formula has no benefits for IPs from 2019 because of provisions of the EU tariff code which meant the revenue needed to be recovered by capacity charges and not commodity charges at IPs. One Workgroup member also suggested that when considering the merits of the modification proposal, the EU gas network access regulations should be taken into account, which stipulate that 'tariffs shall neither restrict market liquidity nor distort trade across borders of different transmission systems'.

The proposer anticipates that Modification 0621 will also address the OCC. The OCC rate under Modification 0636 will remain available as an alternative to any standard commodity charges in effect at

**Deleted:** but at the time of writing this report the content of Modification 0621 was still being developed

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the time. Post 2019, there will remain a “non-transmission services” commodity charge applicable at IPs of a similar magnitude to the SO commodity.

### Notification of changes to the OCC

Given the materiality of the proposal, the workgroup sought clarification of the notice periods that affected parties would receive and the following information was provided by National Grid NTS.

The following is a summary of the process employed by National Grid NTS in relation to the notification of changes to transportation charges:

- Ahead of the two months period typically given for notice of changes to transportation charges, National Grid would require at least one month to calculate: new OCC rates for any approved Modification (636 or any alternate); and updated TO and SO Entry and Exit Commodity rates.
- Ideally any change would take effect from 1st of the month. Current processes for commodity and NTS OCC reconciliation work on a monthly process and billing cycle.

With the above in mind, three months post decision to implement is preferable to allow the appropriate notice to be provided. For example:

- If the implementation date was to be 1 April or 1 October then this would mean certainty needed by end of December or end of June respectively.
- If the implementation was to be 1 December, certainty would be needed by end of August.

NTS OCC Notification - at the same time as the two months notice is given for updated commodity and OCC it is anticipated a process would be followed to advise all registered OCC users of any change to OCC rates and the dates they would become effective. This would be to allow these parties to change their nomination regarding OCC in the relevant systems with Xoserve.

Updated Commodity notification - updated commodity charges would be notified by usual channels with updated charges issued via the Joint Office and updated Transportation Charging Statement.

Some workgroup members required that the 150 business day indicative notice period should apply, as they believe that unwinding any contractual aspects might prove extremely difficult. The concern was acknowledged but it was pointed out that the 150 business days notification requirement is discharged on a 'reasonable endeavours' basis.

Traders have also pointed out that [the annual gas tenders for the upcoming gas year \(from October 2018\) have already started, the majority normally conclude around June/July and that certainty over transportation charges is required to ensure parties are not discouraged from taking part. The reason for this timescale is that time is required ahead of the commencement of the gas year to finalise contractual, operational and regulatory arrangements between parties.](#)

[Traders also highlighted that parties will be subject to legally binding fixed term contracts \(that usually run from 1 October to 30 September\), they will be based on the transportation charges that parties thought would be applicable at the time of entering these agreements and therefore changes after the 1<sup>st</sup> October would not be conducive to an efficient and well-functioning market. Others highlighted that a mid-year change has a higher impact than a change undertaken in October \(start of the Gas Year\) and that any post October change potentially has a significant impact on contractual arrangements \(i.e. unwinding trade hedges for a mid-year change etc.\).](#)

Determination of cost recovery redistributed to Non-OCC Users from OCC Users [cross-subsidy]

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Current OCC rates are significantly below the costs of building the required pipeline. Some workgroup members felt that the current OCC arrangements had led to a two tier system. The choice of OCC is not available for most DN connected load since the commodity charge is applied at Supply Point level rather than the DN offtake. However, there is no difference in the NTS service (covered by Commodity Charges) at the DN Offtake as compared to NTS Direct Connects.

If true costs of pipe-building were known then a more accurate value for the level of redistributed costs to Non-OCC Users from OCC Users could be determined but it is unlikely parties will share information about potential investment decisions.

Analysis of OCC utilisation and OCC rates

Data<sup>20</sup> has been provided by National Grid NTS to enable the proposers (0636, 0636A, 0636B and 0636C) and the workgroup to identify the key impacts of the proposals. The proposer of Modification 0636 undertook the initial analysis with regards to OCC utilisation and OCC rates and a comparison with the standard commodity rates. Points to note about the analysis are as follows:

- Current OCC rates are used in the analysis but are anonymised
- Historic exit flows have been used for Gas Year 2015/6 for "M"
- Average 17/18 commodity rates, flows and revenues and the short-haul data (volumes and revenues) are as included in the October Final charge setting process.

The National Grid NTS data was subsequently updated for both Modifications 0636A, 0636B and 0636C. This analysis section has been updated to reflect this additional information.

a) Impact on number of sites (0636, 0636A, 0636B and 0636C)

The table below was provided by National Grid NTS to clarify the current usage of OCC (including by category) in terms of Exit Points and Contracted Routes and the revised position under 0636 and the alternatives, (assuming shippers choose the cheapest option).

Category	Exit Points				(Unique) Contracted Routes			
	Current	636	636a	636b	Current	636	636a	636b
Industrial	10	5	10	10	10	5	10	10
Power Station	32	17	26	30	32	17	26	30
Interconnector	3	3	2	3	7	5	2	7
<b>Totals</b>	<b>45</b>	<b>25</b>	<b>38</b>	<b>43</b>	<b>49</b>	<b>27</b>	<b>38</b>	<b>47</b>

The analysis confirms that there are currently 49 unique contracted routes where the OCC is being utilised. The analysis conducted implies that this would reduce to 27 (or less) under Modification 0636, 38 under Modification 0636A, 47 for Modification 0636B and X for 0636C.

[To be updated on receipt of a revised table, that includes, 0636C]

b) Impact on distances (0636 and 0636A)

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<sup>20</sup> The information provided by National Grid NTS to support the analysis of 0636, 0636A and 0636B can be found on the following page: <https://www.gasgovernance.co.uk/0636>

The average distance for OCC routes is at present 89km with a maximum distance of 274 km. Under 0636 this reduces to an average distance of 30km but retains a maximum distance of 262km if Users choose the cheapest option under Modification 0636. For 0636A this reduces to an average distance of 23km and a maximum distance of 90km.

c) Breakdown of revenues from current OCC flows (0636)

The table below provides a breakdown of the annual revenue from current OCC flows. The following information supports the table:

- “Remainers” are flows which are currently using OCC via a particular route which remain on the OCC following Mod 0636
- “Leavers” are flows which are currently using OCC via a particular route which switch to standard rate following Mod 0636
- “Never on OCC” are flows which are currently using Standard Commodity rates.

Scenario and Impact	Breakdown of Annual Revenue from Current OCC Flows			Amount re-distributed to “Never on OCC”
	OCC “Remainers”	OCC “Leavers”	Total from OCC flows	
No OCC - Standard Commodity only	£132.93 m	£65.50 m	£198.43 m	-
Current	£14.30 m	£34.00 m	£48.31 m	£150.12 m
Mod 0636	£54.60 m	£75.45 m	£130.05 m	£68.38 m
Impact of Mod 0636	£40.30 m	£41.45 m	£81.74 m	-£81.74 m
Retained benefit after Mod 0636	£78.33 m	-£9.95 m	£68.38 m	

In conclusion Modification 0636 reduces the amount “re-distributed” by £82m and the remaining OCC flows still save £78m compared to Standard rates.

d) Impact of Modification 0636 on Non-OCC Users by Annual Load Size per Annum

The following table shows the annual impact (where negative values represent a saving) for Non-OCC Users split by annual load size. This relates primarily to DN connected loads, both Domestic and I & C, but may also include some loads directly connected to the NTS. The impact assumes that there is no change in the flow levels as a result of Modification 0636.

	Annual Load MWh	Impact £ per annum
Domestic <sup>21</sup>		

<sup>21</sup> Source: <https://www.ofgem.gov.uk/gas/retail-market/monitoring-data-and-statistics/typical-domestic-consumption-values>

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Low	8	-£1.19
Medium	12	-£1.78
High	17	-£2.52
<b>Non-Dom Retail</b> <sup>22</sup>	73.2	-£10.85
<b>Industrial</b> <sup>23</sup>		
I1	< 277.8	-£41.19
I2	277.8 - 2,778	-£412
I3	2,778 - 27,780	-£4,119
I4	27,780 - 277,800	-£41,192
I5	277,800 - 1,111,200	-£164,769

Note: Where the annual load is a range the impact of the top of the range is shown.

e) Impact of Modification 0636 on Standard Commodity Charges (Assuming Shippers Choose Cheapest Option)

The table below shows the impact of Modification 0636 on Standard Commodity charges (assuming Shippers choose the cheapest option).

Commodity Charges	Current p/kWh	Mod 0636 p/kWh	Variance	No OCC
TO Combined Commodity Rate	0.0751	0.0643	-14%	-
SO Combined Commodity Rate	0.0212	0.0172	-19%	-
SO+TO Combined Commodity Rate	0.0963	0.0815	-15%	0.0707

In Conclusion:

- Standard Commodity charges will fall by 15% all other things being equal.

f) Comparison of average rates in p/kWh for OCC versus non-OCC (0636)

<sup>22</sup> Source: <https://www.ofgem.gov.uk/publications-and-updates/retail-energy-markets-2016>

<sup>23</sup> Source: <https://ec.europa.eu/energy/en/data-analysis/market-analysis>

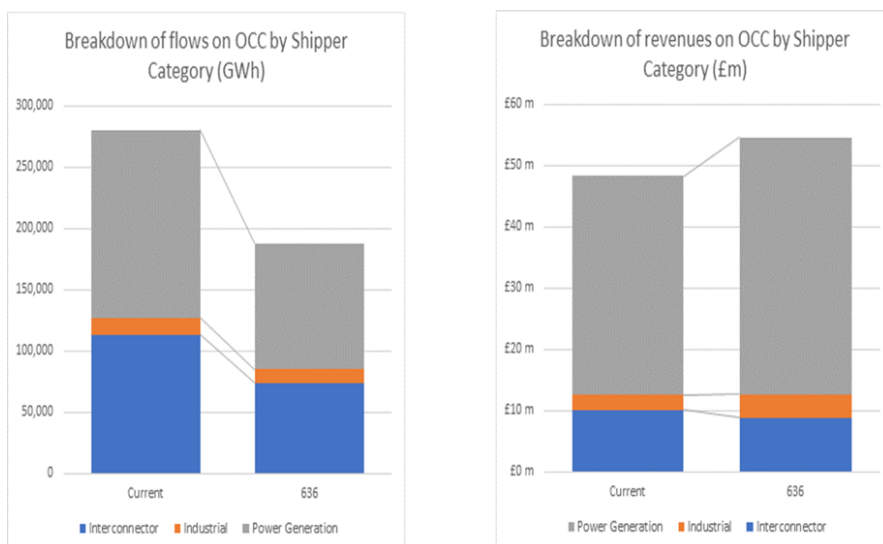
	Current	636	Rate with no OCC
OCC users "remainers"	0.0076	0.0291	0.0707
previous OCC "leavers"	0.0367	0.0815	0.0707
Non OCC users	0.0963	0.0815	0.0707

g) [Raised contribution towards SO charges \(0636\)](#)

The revenue recovered via the OCC will continue to contribute to the SO allowed revenues.

h) [Distributional effects on charges for OCC Users \(0636\)](#)

[Comparison of Flows and Revenues for OCC Users by Shipper Category](#)



The following tables provides the data to support the above graph.

Breakdown of revenues on OCC by Shipper Category (£m)		
	Current	636
<b>Interconnector</b>	£10 m	£9 m
<b>Industrial</b>	£2 m	£4 m
<b>Power Generation</b>	£36 m	£42 m

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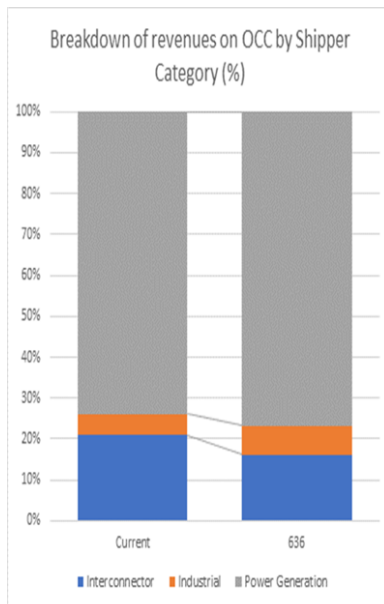
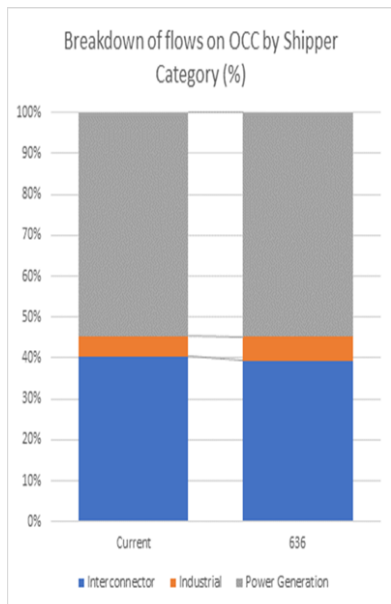
<b>Total</b>	<b>£48 m</b>	<b>£55 m</b>

Breakdown of flows on OCC by Shipper Category (GWh)		
	Current	636
<b>Interconnector</b>	113,277	74,142
<b>Industrial</b>	13,857	10,909
<b>Power Generation</b>	153,429	102,901
<b>Total</b>	<b>280,562</b>	<b>187,952</b>

In conclusion:

- Average rates for flows remaining on OCC increase by a factor of 4 and for flows “leaving” OCC increase by a factor of 2
- OCC flows reduce in absolute terms for all shipper categories although the % split by shipper category hardly changes
- Revenues from OCC flows increase despite lower flows.

Comparison of Flows and Revenues for OCC Users by Shipper Category – percentages



The following tables provides the data to support the above graph.

Breakdown of flows on OCC by Shipper Category (%)		
	Current	636
<b>Interconnector</b>	40.37%	39.45%
<b>Industrial</b>	4.94%	5.80%
<b>Power Generation</b>	54.69%	54.75%

Breakdown of revenues on OCC by Shipper Category (%)		
	Current	636
<b>Interconnector</b>	20.89%	16.23%
<b>Industrial</b>	5.16%	7.01%
<b>Power Generation</b>	73.96%	76.76%

In conclusion:

- Standard Commodity charges may reduce by 15% under 0636

[i\) Impacts of the distance Cap specified in Modification 0636A](#)

The inclusion of a distance cap in the OCC formula will remove any routes which exceed this distance from operating under the OCC. The distance of 115 km has been selected on the basis of the analysis provided by National Grid to NTS Charging Methodology Forum on 6 May 2015. National Grid NTS had informed the proposer that the average distance (in terms of route) of the top 25% (by distance) of OCC users is 115 km (based on April 2014 flows). National Grid NTS were not able to provide any more detailed distance related information over and above what has already been provided on the grounds that the 115km figure allows for sufficient distance between any two reference points.

Some workgroup members raised concerns around the justification for the chosen distance cap and highlighted bypass lengths above 115km and therefore they thought the cap was subjective. The proposer felt that the 115km was a transitional step until Modification 0621 was implemented (60km is currently being proposed).

The following data was provided by National Grid NTS on the impacts of 0636A.

	Flow on OCC	Flow no longer on OCC	Revenue from OCC Flows	Commodity revenue from flows no longer on OCC	Amount OCC flows would pay in Commodity Revenue if no OCC	Amount redistributed to non-OCC users
<b>Current</b>	280,562.15	-	£ 48,307,149.72	£ -	£ 198,430,184.39	£ 150,123,034.67
<b>636a</b>	197,736.10	82,826.05	£ 26,213,137.98	£ 71,667,571.77	£ 139,850,692.93	£ 113,637,554.95

In summary the impacts of Modification 0636A are:

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- Flows on OCC reduce by 30% and revenue from these remaining OCC flows reduces to £26.2m
- Those no longer on OCC ("leavers") would pay £71.3m (an additional 49.2m)
- Overall the amount "re-distributed" reduces by £36.5m and the remaining OCC flows save £113.6m compared to if they were on Standard Commodity rates.

### j) Impacts of Modification 0636B

The following data was provided by National Grid NTS on the impacts of 0636B.

	Flow on OCC	Flow no longer on OCC	Revenue from OCC Flows	Commodity revenue from flows no longer on OCC	Amount OCC flows would pay in Commodity Revenue if no OCC	Amount redistributed to non-OCC users
Current	280,562.15	-	£48,307,149.72	£ -	£198,430,184.39	£150,123,034.67
636b	280,271.80	290.36	£60,929,550.18	£ 267,976.80	£198,224,828.04	£137,295,277.85

In summary the impacts of Modification 0636B are:

- Flows on OCC reduce by a minimal amount but the revenue from these remaining OCC flows increases to £60.9m (additional £12.62m)
- Those no longer on OCC ("leavers") would pay £0.27m
- Overall the amount "re-distributed" reduces by £12.8m and the remaining OCC flows save £137.3m compared to if they were on Standard Commodity rates.

### k) Impacts of Modification 0636C

[NTS have been requested to provide analysis for 0636C]

#### Resulting Impacts on OCC Users from changes to the OCC

Some workgroup members felt that the proposed changes will have significant distributional impacts; a small number of parties seeing a large increase in transportation charges, whilst others will see a small decrease. In all of the Modifications (with the exception of 0636A for sites <115km and 0636C for IPs) the OCC rate will increase. The analysis conducted suggests the following potential increases (approx.) to Shippers that could then be passed on to consumers:

- Very Large Consumers – currently 49 contracted routes utilise the OCC and the analysis conducted implies that this would reduce to 27 under 0636, 38 for 0636A, 47 for 0636B and X for 0636C. These contracted routes relate to 45 exit points which represents a significant proportion of the direct NTS offtakes, which are operational. The direct connects will be combination of I&C and power generation offtakes, as well as the three interconnectors.
- The analysis also concludes that Modification 0636 increases the amount charged by £82m (£40.3m for those remaining on OCC and £41.45m for those leaving OCC). Modification 0636A increases the charges (for those leaving OCC) by £49.2m. Modification 0636B increases the charges to those remaining on OCC by £12.6m and Modification 0636C

[to be updated following receipt of 0636C Analysis]

Views on the impacts of the redistribution of charges is as follows:

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- Some workgroup members felt that the increased OCC could put some of those **NTS direct connect consumers (large I&C)** out of business;
- If demand fell on the **Interconnection Points** because the OCC is too high, increased costs (gas and electricity) could be picked up by consumers;
- **Electricity generation** - increased electricity costs could be passed on to consumers, as a result of an increase in the OCC.
- **Attracting gas to GB** – a concern was raised that if the OCC is too high, then flows could be diverted to other markets.
- **Trading** – future trading would carry on with regards to flows remaining on the OCC, although there would be a need to a sufficient notice period to reduce the impact on trading.

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The following information was provided by a workgroup member to support the above views:

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- In the case of non-interconnectors, the offtakes will be involved in secondary markets e.g. global widget market or UK power market. On the assumption that the increase in gas transmission costs are able to be passed through via inflated prices in these secondary markets e.g. the power station is the marginal power supplier (setting the marginal price) then the impact would be felt by the purchasers of the secondary product in that market e.g. higher power price. More likely is that the offtake will have to absorb the additional transmission cost and either face reduced margins, or potentially reduce production, in order to reduce other related costs, to the point where marginal costs = marginal revenues. In some cases, this may result in complete shutdown of an offtake, where other efficiencies cannot be achieved and the marginal costs always exceed marginal revenues at all levels of production.
- Industrial offtakes will be more price sensitive (more price elastic) than many other consumers on the system and given the cost increases are likely to be of a magnitude higher than the price reductions experienced by non-OCC users (resulting reductions in commodity charges), it should be expected that overall system demand will at best, stay at the same level, or fall (compared to current demand). Any reduction in demand will reduce the benefit of the reduced non-OCC commodity charges, by virtue of the fact that the allowed revenue will be recovered over a lower level of throughput.

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The proposer felt that although OCC Users will see increases in their charges, that these are to be more reflective of the costs underlying a by-pass pipeline that they would have to build if they did not want to avail of the NTS. The Proposer also considers the costings in Modification 0636 to be conservative in nature as the assumed pipe-size is lower that may be necessary to meet peak consumption levels and believes there are still considerable benefits to Users availing of the OCC (such as the flexibility to change routes, no requirement for up-front investment costs and access to the NBP).

An Initial Rep highlighted that the GCD11 Option 2 (proposal) results in a greater contribution towards SO costs by shorthaulers and felt the validity of this outcome needs to be investigated if the charges are to be deemed to be cost reflective.

The proposer believes standard commodity charges are levied as a combined commodity rate. The OCC rate is defined as an SO charge for National Grid reporting purposes only. The proposer felt that if this is an important issue National Grid could re-appoint/allocate. This will have no impact on the underlying cost reflectivity of the costs of pipe-building.

### Contractual arrangements



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The Workgroup considered contracts in relation to the timing of the proposed change. Although standard commodity charges are changed in April & October each year, there was an expectation amongst some Workgroup members that the current formula would remain ASIS until October 2019.

Some workgroup members indicated that some contracts are in place that will be impacted by this proposal; some are multiple year, and some were struck based on view that no changes were expected before October 2019. [As mentioned earlier, Traders have also pointed out that the annual gas tenders for the upcoming gas year \(from October 2018\) have already started and that the majority normally conclude around June/July and that the legally binding fixed term contracts \(that usually run from 1 October to 30 September\) will be based on the transportation charges that parties thought would be applicable at the time of entering these agreements.](#)

A discussion was had by the workgroup on the value of including a specific question in the consultation to gather supporting evidence for the workgroup report or whether it needed to be provided to Ofgem direct. In conclusion it was assumed that contracts and specific investment projects will be confidential and therefore parties would be best to share details with Ofgem.

### 6. Assessment of implementation costs

The 0636 solution will cost at least £4,000, but probably not more than £7,000 to develop.

For 0636A:

- The System solution will cost at least £135k, but probably not more than £190k to develop
- The Report Only Solution would cost at least £4k but probably not more than £6.5k to develop
- The Manual Interim Solution would cost at least £5k but probably not more than £10k to develop.

For 0636B no system development costs are expected as a result of this proposal.

[For 0636C...](#)

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### 7. Assessment of legal text.

The Workgroup has considered the Legal Text for 0636, 0636A, 0636B and [0636C] and have indicated that it meets the intent of the relevant Solutions.

[The Workgroup has not yet considered the Legal Text for 0636C.]

### Rough Order of Magnitude (ROM) Assessment

The ROM responses for Modification 0636 and 0636A has been published under change proposal (XRN 4543A) and a summary is as follows:

#### Modification 0636

- Change Costs (implementation): The solution will cost at least £4,000, but probably not more than £7,000 to develop This change will only Impact DSC BCM Service area 7.
- Change Costs (on-going): The on-going costs are likely to be negligible and have not been included.
- Timescales: The development of the change could start early 2018 and is likely to take 10 to 15 business days to deliver.

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- Assumptions: The numeric parameters in the formula have never been changed so it is assumed but not yet confirmed that these can be changed through normal price change procedures and the formula work as required thereafter.

### Modification 0636A

Three options are highlighted in the ROM response:

- **System Solution Option** - this option would require an additional validation when NOM and SPC files are received by Xoserve and reject where the Distance is greater than 115km and new rejection code is required. The System solution will cost at least £135k, but probably not more than £190k to develop. Due to the current change programme it is unlikely that an implementation of the System Solution Option for UNC Modification 0636A is possible before October 2018.
- Additional consideration (**CDSP Forced Confirmation (>115 km) Solution Option**) - Where the Shipper User fails to act, then the CDSP are often required to act to (re)confirm Supply Meter Points (SMP). This option would mean any sites outside the distance parameter are excluded at the right time. However, no CDSP functionality exists to (re) confirm Class 1 SMPs and the process would be complicated and have large impacts on CDSP operational teams. This is due to the expected complexity for Class 1 SMPs and because of the time allowed for analysis, no costs are available at this time for this process.
- **Manual Interim Solution Option** - this Option involves the CDSP Operational teams amending data via system screens and manually creating Gemini work items. Support would be also be required to update SAP tables and analysis for potential system impacts. The Manual Interim Solution would cost at least £5k but probably not more than £10k to develop. The manual interim solution also has ongoing costs that are likely to be at least £7k but probably not more than £13k per annum.
- **Report only Solution** - this solution provides a report to National Grid Transmission where SMPs that have requested OCC and 'D' is greater than the distance parameter specified (i.e. 115km). The Report Only Solution would cost at least £4k but probably not more than £6.5k to develop.

### Modification 0636B

- No system development costs are expected as a result of this proposal. However, it is expected that it would be prudent to undertake a short testing phase / validation checks in advance of configuration change.
- No new Service charges are expected and any future and any on-going costs are likely to be negligible.

### Modification 0636C

[The ROM request for 0636C has been made and we are awaiting the response].

## 7 Relevant Objectives

### Impact of the modification on the Relevant Objectives:

Relevant Objective	Identified impact
a) Efficient and economic operation of the pipe-line system.	None
b) Coordinated, efficient and economic operation of (i) the combined pipe-line system, and/ or (ii) the pipe-line system of one or more other relevant gas transporters.	None
c) Efficient discharge of the licensee's obligations.	None
d) Securing of effective competition: (i) between relevant shippers; (ii) between relevant suppliers; and/or (iii) between DN operators (who have entered into transportation arrangements with other relevant gas transporters) and relevant shippers.	None
e) Provision of reasonable economic incentives for relevant suppliers to secure that the domestic customer supply security standards... are satisfied as respects the availability of gas to their domestic customers.	None
f) Promotion of efficiency in the implementation and administration of the Code.	None
g) Compliance with the Regulation and any relevant legally binding decisions of the European Commission and/or the Agency for the Co-operation of Energy Regulators.	None

### Impact of the modification on the Relevant Charging Methodology Objectives:

Relevant Objective	Identified impact
a) Save in so far as paragraphs (aa) or (d) apply, that compliance with the charging methodology results in charges which reflect the costs incurred by the licensee in its transportation business;	Positive
aa) That, in so far as prices in respect of transportation arrangements are established by auction, either: (i) no reserve price is applied, or (ii) that reserve price is set at a level - (I) best calculated to promote efficiency and avoid undue preference in the supply of transportation services; and (II) best calculated to promote competition between gas suppliers and between gas shippers;	None
b) That, so far as is consistent with sub-paragraph (a), the charging methodology properly takes account of developments in the transportation business;	Positive

c) That, so far as is consistent with sub-paragraphs (a) and (b), compliance with the charging methodology facilitates effective competition between gas shippers and between gas suppliers; and	Positive
d) That the charging methodology reflects any alternative arrangements put in place in accordance with a determination made by the Secretary of State under paragraph 2A(a) of Standard Special Condition A27 (Disposal of Assets).	None
e) Compliance with the Regulation and any relevant legally binding decisions of the European Commission and/or the Agency for the Co-operation of Energy Regulators.	Positive

Modifications 0636, 0636A and 0636C: Adjustments to the OCC rate will reduce the Standard Commodity rates (all other things being equal) and improve its cost reflectivity – **relevant objective (a)**.

Some workgroup members considered that modification 0636 better facilitates relevant objective a) as the reduction in the Standard Commodity rates is greater for 0636 than 0636A, 0636B and 0636C.

Modifications 0636, 0636A, and 0636C: An OCC rate that better reflects the underlying costs of appropriately sized alternative by-pass pipelines will better facilitate effective competition between shippers and suppliers – **relevant objective (c)** and specifically, help reduce transportation costs to domestic gas customers.

Modifications 0636B: An OCC rate that better reflects the underlying costs of appropriately sized alternative by-pass pipelines will better facilitate effective competition between shippers and suppliers – **relevant objective (c)**

Modifications 0636, 0636A, and 0636C: Increasing take-up of the OCC over longer distances has led to a need to review the parameters within the OCC rate calculation – **relevant objective (b)**.

Modification 0636B: Increasing take-up of the OCC over longer distances has led to a need to review the parameters within the OCC rate calculation – **relevant objective (b)**. Similarly, the rate needs to avoid inefficient bypass of the NTS, failure to do so will increase costs to customers as allowed revenue will be recovered on a smaller charging base.

Modification 0636B: relevant objective e) - Ensuring that a documented Methodology Statement is available for the UNC Panel before the modifications go to consultation will ensure that 0636B better meets the transparency requirements of EU Regulation 715/2009 Article 13 than the other alternative modification proposals.

*“Tariffs, or the methodologies used to calculate them, applied by the transmission system operators and approved by the regulatory authorities pursuant to Article 41(6) of Directive 2009/73/EC, as well as tariffs published pursuant to Article 32(1) of that Directive, shall be transparent...”*

Modification 0636C: relevant objective e) - excluding Interconnection Points (IPs) facilitates compliance with the TAR NC intention of full consultation with affected adjacent markets and ACER. The TAR NC specifically refers to consideration and treatment of IPs and exit points to infrastructure with the purpose of ending isolation of Member States’ gas systems; Northern Ireland and the Republic of Ireland constitute isolated systems. Full consultation as described for TAR NC compliance is already planned to take place under Modification 0621, where any change at IPs shall be assessed by relevant parties in affected adjacent markets and TAR NC compliance is better served.

## 8 Implementation

- The usual date for charging changes is October or April in any year (but changes can be implemented at other dates subject to Ofgem approval). Ideally the proposer would like to implement the modification proposal on 1 October 2018.
- If decision to implement is received after 31 July 2018, implementation 2 calendar months following the decision to implement.

Should the proposal proceed, National Grid will be asked to give (on an “all reasonable endeavours” basis) 150 days’ indicative notice that the OCC rate may change at exit points availing of the OCC and if possible an indicative rate as per Standard Special Condition A4 of the National Grid NTS Gas Transporter Licence. Similarly, National Grid will be asked to give 2 months’ notice of the actual charges should the Modification be approved.

## 9 Legal Text

[The legal text and commentary for Modifications 0636, 0636A, 0636B and [0636C] has been published alongside this report.]

## 10 Recommendations

### Workgroup’s Recommendation to Panel

The Workgroup asks Panel to agree that:

- [This proposal requires further assessment and should be returned to Workgroup.]
- This modification should proceed to consultation.

## 11 Appendix 1

GCD11 document:

“42342-NTS GCD11 - Optional Commodity Charge Change V1.3”

<https://www.gasgovernance.co.uk/sites/default/files/ggf/book/2017-11/42342-NTS%20GCD11%20-%20Optional%20Commodity%20Charge%20Change%20V1.3.pdf>

## 12 Appendix 2

GCD11 Discussion report:

“NTS GCD11R - Updating the Cost Inputs to the NTS Optional Commodity Charge Function”

<https://www.gasgovernance.co.uk/sites/default/files/ggf/book/2017-11/44428-NTS%20GCD11R%20Discussion%20Report.pdf>

### 13 Appendix 3 – Comparison of Pipeline Construction Costs

As part of the recent Charging Review work, stakeholders were asked to provide any data that they could share in regard to recent pipe-building costs so as to consider the validity of the underlying costs used within the GCD11 Discussion and hence Modification 0636. There was a limited response to the request potentially because of the confidential nature of pipe-building costs and associated investment decisions amongst the shipper community. The data that has been provided is summarised below and shows consistency between these data sources. In the absence of more comprehensive data (which Workgroup members stated was unlikely to materialise<sup>24</sup>) these costs are considered by the Proposer to be appropriate for the purposes of bringing the OCC rate to a more realistic value, than those currently underlying the OCC rates.

	Diameter	length	equivalent pipeline capacity	cost		comment
GNI Pipeline Scotland <sup>25</sup>	914mm	50km	500 GWh/d	€92.9m	£80m	assumed entry and exit pressures 85bar and 70bar
Germany - Gas TSOs <sup>26</sup>	900mm	50km		€90.5m	£78m	
NG - derived cost from GCD11 Formula	915mm	50km			£82m	

### 14 Appendix 4 – Contribution to Costs

The following is an extract from a larger document presented to the NTSCMF on 2 August 2017<sup>27</sup>. Table 1 below shows the estimated costs of by-pass pipelines for the likely NTS direct connections that could benefit from the OCC. A major assumption in the calculation of the current OCC rate is the 75% load factor and National Grid have confirmed that this assumption is significantly higher than the typical load factor observed at present. The following conclusion is also an extraction from the document.

<sup>24</sup> Users have been asked to provide cost data during both the GCD11 development in 2015 and again more recently during the current Charging Review.

<sup>25</sup> <https://ec.europa.eu/inea/en/connecting-europe-facility/cef-energy/projects-by-country/united-kingdom/5.2-0042-uk-p-m-14>

<sup>26</sup> <http://www.fnb-gas.de/en/network-development/ndp-2016/nep-2016.html>

<sup>27</sup> The full document is available on the JO website at <https://www.gasgovernance.co.uk/sites/default/files/ggf/page/2017-08/Inefficient%20Bypass%20of%20NTS%20-%20KEL%20Paper%20for%202%20Aug%20%2717%20NTSCMF.pdf>

National Grid NTS have advised that only about 60% of gas flows to eligible exit points avail of the NTS Optional Commodity charge. Hence, about £28 million would be paid by these sites by way of the shorthaul tariff as compared to the £298 million that National Grid estimate that the sites would have to pay to fund the construction and operation of the bypass pipelines (NB both figures are on an annual basis). To put this in perspective, the £28 million is less than 50% of what it would cost just to operate the bypass pipelines. The total cost of constructing these bypass pipelines is in excess of £1.6 billion.

Exit Points			Optional Commodity Charge			Cost of Bypass Pipeline			
Obligated Exit Capacity kWh/day	Historical Flows at Exit kWh/day	Distance to Nearest Entry km	p/kWh	% of TOSO	Amount paid by Users	Option 2 OCC	Annual Cost with Annuitised Pipe	Annual Operating Cost	Cost of Construction
DC1	108,300,000	6,623,287	0.0020	2%	£48,823	0.0029	£863,705	£172,741	£4,670,224
DC2	73,210,000	1,057,700	0.0026	3%	£10,072	0.0038	£770,386	£154,077	£4,165,630
DC3	121,200,056	72,785,150	0.0034	4%	£906,341	0.0070	£2,335,218	£467,044	£12,626,990
DC4	38,120,000	12,697,892	0.0047	5%	£215,556	0.0081	£841,680	£168,236	£4,551,134
DC5	28,480,000	2,905,176	0.0053	5%	£55,709	0.0086	£669,699	£133,540	£3,621,195
DC6	20,040,000	11,454,140	0.0061	6%	£254,519	0.0096	£527,725	£105,545	£2,853,516
DC7	40,940,000	24,025,310	0.0064	7%	£557,390	0.0126	£1,410,307	£282,061	£7,625,811
DC8	13,276,800	4,334,319	0.0080	8%	£126,072	0.0129	£467,947	£93,589	£2,530,285
DC9	43,540,000	14,946,299	0.0081	8%	£443,037	0.0175	£2,085,222	£417,044	£11,275,211
DC10	9,750,000	2,980,266	0.0106	11%	£114,817	0.0180	£480,573	£96,115	£2,598,556
DC11	91,000,001	7,732,386	0.0125	13%	£352,703	0.0318	£7,930,162	£1,586,032	£42,879,974
DC12	57,830,000	36,749,960	0.0128	13%	£1,721,054	0.0312	£4,935,010	£987,002	£26,684,585
DC13	67,000,000	46,408,598	0.0160	16%	£2,706,142	0.0403	£7,396,873	£1,479,375	£39,996,369
DC14	3,690,000	258,556	0.0184	19%	£17,375	0.0319	£321,977	£64,395	£1,740,996
DC15	38,600,000	5,536,770	0.0201	21%	£466,422	0.0490	£5,181,261	£1,036,252	£28,016,114
DC16	68,012,169	12,078,753	0.0204	21%	£898,588	0.0525	£9,773,567	£1,954,713	£52,847,632
DC17	40,840,000	17,663,742	0.0208	21%	£1,343,647	0.0513	£5,730,910	£1,146,182	£30,988,178
DC18	2,583,336	3,267	0.0232	24%	£277	0.0410	£290,142	£58,028	£1,568,856
DC19	66,000,000	33,866,070	0.0272	28%	£3,357,465	0.0709	£12,814,427	£2,562,885	£69,290,172
DC20	5,520,000	80,702	0.0304	31%	£8,948	0.0629	£950,006	£180,001	£5,136,870
DC21	82,000,000	52,401,011	0.0352	36%	£6,726,696	0.0944	£21,180,296	£4,236,059	£114,526,097
DC22	1,000,000	12,345	0.0432	44%	£1,948	0.0803	£219,914	£43,983	£1,189,121
DC23	45,000,000	5,502,061	0.0455	47%	£913,222	0.1179	£14,525,466	£2,904,091	£78,515,066
DC24	42,020,000	22,596,857	0.0496	51%	£4,087,408	0.1282	£14,748,003	£2,949,601	£79,745,404
DC25	137,760,000	29,267,580	0.0537	55%	£5,733,502	0.1506	£56,791,478	£11,358,296	£307,082,877
DC26	38,660,000	5,025,400	0.0561	58%	£1,029,573	0.1449	£15,340,025	£3,068,005	£82,946,585
DC27	11,700,000	669,969	0.0569	58%	£139,215	0.1346	£4,310,496	£862,099	£23,307,712
DC28	36,050,000	3,498,548	0.0591	61%	£754,734	0.1521	£15,017,386	£3,003,477	£81,202,008
DC29	9,100,000	3,914,012	0.0614	63%	£876,600	0.1428	£3,557,402	£711,480	£19,235,585
DC30	48,650,000	12,027,063	0.0621	64%	£2,727,353	0.1634	£21,766,188	£4,353,238	£117,694,133
DC31	37,470,000	7,981,283	0.0626	64%	£1,824,141	0.1619	£16,604,167	£3,320,833	£89,782,053
DC32	19,300,000	8,065,992	0.0732	75%	£2,155,390	0.1816	£9,596,374	£1,919,275	£51,889,516
DC33	16,890,000	152,750	0.0817	84%	£45,528	0.2014	£9,334,022	£1,862,804	£50,362,782
DC34	15,380,000	4,986,083	0.0914	94%	£1,663,685	0.2249	£9,446,901	£1,893,380	£51,189,427
DC35	19,600,000	5,288,307	0.0917	94%	£1,769,364	0.2292	£12,297,744	£2,459,249	£66,496,361
DC36	12,350,000	6,262,078	0.0944	97%	£2,157,438	0.2289	£7,750,107	£1,548,021	£41,852,307
Totals ==>						£46,154,672	£298,247,769	£59,649,554	£1,612,685,337

Table 1: DC Sites for which the Optional Commodity Charge may be practical option

## 15 Appendix 5 - Compact Version of Methodology Spreadsheet

Pipeline Diameters for a range of distances and peak-day flowrates		Step a Pipe Diameters	Step b Connection Costs	Total Capital Costs	Annuitised Capex	Step c Annuitised Capex + Opex	Step d Unit Costs	Step e	
This column calculates the supply point capacities using an average load factor of 75% of the SOQ. This is used to calculate the Annual Quantity AQ in GWh that will be used to calculate the cost per kWh.		This Column shows the pipe diameters in mm required to meet range of typical peak day flowrates for a 50km pipeline.	These columns contain a total value of some of the non-distance related costs (e.g. Pipeline connection, Pig traps, Calorimetry, Pressure reduction and volumetric control) for each of the peak day flowrates. Please note these have been indexed to 15/16 prices using RPI.	This column calculates the sum of the connection costs (indexed by RPI) plus pipelining costs (variable costs indexed by Steel Index and RPI from 2010 onwards, and non-variable costs indexed solely by RPI).	This column calculates the total project cost per annum using the 10 year discount factor calculated in the discount factor table below.	This column calculates the annuitised Capex + Opex costs using the assumptions detailed in the additional costs table.	This column divides the annuitised costs in step c by the annual quantities corresponding to the supply point capacities using an average load factor of 75% to generate a unit cost by supply point capacity, expressed in p/kWh for a range of supply point capacities and for 0 and 50 km.	This column calculates the unit cost per kilometre.	
Load Factor: 75%		RPI Indexation to:			For pipes of length 0 km				
		1998 Prices      2009/10 Prices      2015/16 Prices			Total Capital Costs	Annuitised Capex	Annuitised Capex + Opex	Unit Costs at 75% LF	
SOQ(mcmd)	SOQ (KWh)	AQ (mkWh)							
60	849,800,000	177,883	1.36	1.23	£5,862,713	£867,714	£1,147,336	0.00064	
50	541,500,000	148,236	3,525	4,779	5,863	£5,862,713	£867,714	£1,147,336	0.00077
40	433,200,000	118,589	3,525	4,779	5,863	£5,862,713	£867,714	£1,147,336	0.00129
30	324,900,000	88,941	3,525	4,779	5,863	£5,862,713	£867,714	£1,147,336	0.00193
20	216,600,000	59,294	3,525	4,779	5,863	£5,862,713	£867,714	£1,147,336	0.00258
15	162,450,000	44,471	3,100	4,244	5,206	£5,205,756	£770,490	£1,033,679	0.00291
12	129,960,000	35,577	2,930	3,973	4,873	£4,873,120	£721,248	£976,131	0.00329
10	108,300,000	29,647	2,630	3,566	4,374	£4,374,166	£647,401	£889,809	0.00429
7	75,810,000	20,753	2,630	3,566	4,374	£4,374,166	£647,401	£823,282	0.00555
5	54,150,000	14,824	2,275	3,085	3,784	£3,783,737	£560,014	£721,134	0.00608
4	43,320,000	11,859	1,940	2,630	3,227	£3,226,571	£477,550	£624,742	0.00702
3	32,490,000	8,894	1,905	2,583	3,168	£3,168,360	£468,935	£614,671	0.01037
2	21,660,000	5,929	1,595	2,041	2,603	£2,503,087	£370,471	£499,575	0.01685
1	10,830,000	2,965	1,095	1,485	1,821	£1,821,183	£269,545	£315,075	0.02125
0.5	5,415,000	1,482	1,095	1,485	1,821	£1,821,183	£269,545	£315,075	0.02657
0.4	4,332,000	1,186	915	1,241	1,522	£1,521,811	£225,236	£263,282	0.02980
0.3	3,249,000	889	915	1,241	1,522	£1,521,811	£225,236	£263,282	0.04440
0.2	2,166,000	593	770	1,044	1,281	£1,280,849	£189,543	£221,559	0.07473
0.1	1,083,000	296							
<b>50</b>									
For pipes of length 50 km									
SOQ(mcmd)	SOQ (KWh)	AQ (mkWh)	50 km		Total Capital Costs	Annuitised Capex	Annuitised Capex + Opex	Unit Costs at 75% LF	Unit Costs per Km
60	849,800,000	177,883	915		£61,872,355	£9,157,448	£10,886,968	0.01836	0.00033
50	541,500,000	148,236	915		£61,872,355	£9,157,448	£10,886,968	0.02448	0.00044
40	433,200,000	118,589	915		£61,215,398	£9,060,215	£10,773,311	0.03028	0.00055
30	324,900,000	88,941	915		£60,882,762	£9,010,983	£10,715,763	0.03614	0.00066
20	216,600,000	59,294	600		£52,449,162	£7,762,764	£9,375,724	0.04518	0.00085
15	162,450,000	44,471	600		£52,449,162	£7,762,764	£9,309,197	0.06280	0.00114
12	129,960,000	35,577	600		£51,858,733	£7,675,377	£9,207,049	0.07764	0.00143
10	108,300,000	29,647	600		£35,667,625	£5,279,004	£6,640,408	0.07466	0.00135
7	75,810,000	20,753	450		£35,609,414	£5,270,389	£6,630,337	0.11182	0.00203
5	54,150,000	14,824	450		£30,069,042	£4,450,383	£5,744,949	0.19378	0.00354
4	43,320,000	11,859	450		£29,387,137	£4,349,458	£5,580,446	0.37511	0.00708
3	32,490,000	8,894	300		£27,989,855	£4,050,889	£5,241,707	0.44201	0.00831
2	21,660,000	5,929	300		£27,070,482	£4,006,580	£5,189,914	0.58352	0.01108
1	10,830,000	2,965	200		£27,070,482	£4,006,580	£5,189,914	0.87528	0.01666
0.5	5,415,000	1,482	200		£21,786,114	£3,224,464	£4,351,337	1.46771	0.02786
0.4	4,332,000	1,186	150						
0.3	3,249,000	889	150						
0.2	2,166,000	593	150						
0.1	1,083,000	296	100						



**Pipelaying Unit Costs**

Pipe size Diam. (mm)	1998 Unit Cost £/km	Steel Index		2015/16 Unit Costs £/km
		2009/10 Prices	2015/16 Prices	
50	125,000	274,091	336,214	336,214
100	150,000	328,909	403,457	403,457
150	187,500	411,137	504,321	504,321
200	202,500	444,028	544,666	544,666
300	238,750	523,514	642,168	642,168
450	355,000	778,419	954,847	954,847
600	414,000	907,790	1,113,540	1,113,540
610		*****	*****	*****
915		*****	*****	*****
1220		*****	*****	*****

This table contains the unit costs per km based on historical planning and design specification for the different pipe sizes based on values used to produce the NTS Optional Commodity Charge formula in 1998. **Please note these have been indexed to 9/10 using steel index and then indexed from 9/10 to 15/16 using RPI.**

This section contains the Ofgem provided unit costs in 9/10 prices and these are indexed to 15/16 using RPI. **Please note because of the sensitivity of these costs they have not been published.**

New pipe sizes	Cost	Pipelaying costs contribution (%)
610	*****	90.95
915	*****	94.21
1220	*****	95.86

This table calculates the split between connection and distance-related (pipelaying) costs for the new pipe sizes to maintain consistency with the original data. This is because the cost of the new pipe sizes are only available as composite values. **Please note because of the sensitivity of these costs they have not been published.**

**Additional Costs**

Expenditure Type	Additional Costs	Original	RPI Indexation	
			2009/10 Price	2015/16 Price
			<b>1.355873179</b>	<b>1.226649302</b>
Opex	Where flow rate is between 1 and 5 mcmd, inclusive	40,000	54,235	66,527
	Where flow rate is between 7 and 60 mcmd, inclusive	80,000	108,470	133,054
	Where distance is greater than 0km	35,000	47,456	58,211
	Cost per km added to all those with a distance greater than 0km	10,000	13,559	16,632
Capex	Non-variable pipelaying costs at 50km and above	200,000	271,175	332,636
Opex	1% of the annuitised pipeline costs	1%		
	2.5% of the annuitised connection cost	2.5%		

This table contains the additional costs forming the Opex estimation, with RPI indexation.

**10 year discount factor**

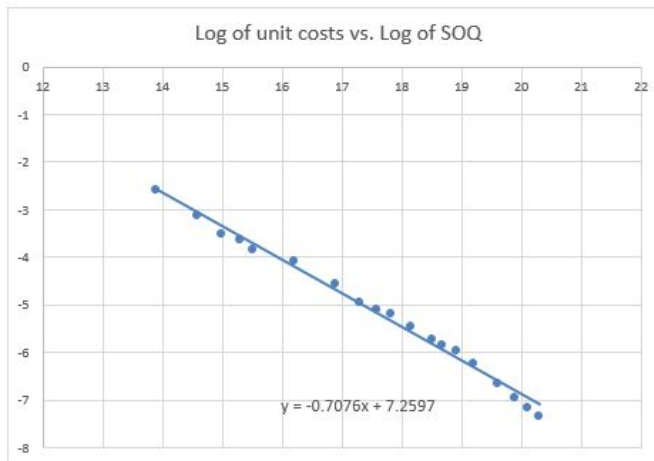
1
0.909
0.826281
0.751089429
0.682740291
0.620610924
0.56413533
0.512799015
0.466134305
0.423716083
<b>6.76</b>

This table shows how the ten year discount factor used in this model is calculated and this discount factor is used to calculate the annuitised cost.

**= 10yr discount factor**

**Parameters for formula**

Non-distance:  
exponent= -0.708  
multiplier= 1422



Distance:  
exponent= -0.780  
multiplier= 1247

