Representation - Draft Modification Report

UNC 0621; 0621A; 0621B; 0621C; 0621D; 0621E; 0621F; 0621H; 0621J; 0621K*; 0621L

Amendments to Gas Transmission Charging Regime

* Amendments to Gas Transmission Charging Regime and the treatment of Gas Storage

Responses invited by: 5pm on 22 June 2018

To: enquiries@gasgovernance.co.uk

Representative:	Samuele Repetto
Organisation:	EDF Trading ltd.
Date of Representation:	22/06/2018
Support or oppose implementation?	0621 - Oppose 0621A - Comments 0621B – Qualified Support 0621C - Comments 0621D - Oppose 0621E - Oppose 0621F – Comments 0621H – Oppose 0621J – Oppose 0621K – Comments 0621L - Oppose
Expression of Preference:	*If either 0621; 0621A; 0621B; 0621C; 0621D; 0621E; 0621F; 0621H; 0621J; 0621K or 0621L were to be implemented, which ONE modification would be your preference?* 0621B

Standard Objective:	**Relevant**

0621
a) Negative
c) None
d) Negative
g) Positive

0621A
a) Negative
c) None
d) Negative
g) Positive

0621B
a) Positive
c) None
d) None
g) Positive

0621C
a) None
c) None
d) Negative
g) Positive

0621D
a) Negative
c) Negative
d) Negative
g) Positive

0621E
a) Negative
c) None
d) Negative
g) Positive

0621F
a) Negative
c) None
d) Negative
g) Negative

0621H
a) Negative
c) Negative
d) Negative
g) Positive

0621J
a) Negative
c) Negative
d) Negative
g) Positive

0621K
a) Negative
c) None
d) Negative
g) Positive

0621L
a) Negative
c) None
d) Negative
g) Positive

Charging Methodology Relevant Objective:	0621 **a)** Negative **aa)** Negative **b)** Positive **c)** Negative **e)** Positive 0621A **a)** Negative **aa)** Negative **b)** Positive **c)** Negative **e)** Positive 0621B **a)** None **aa)** None **b)** Positive **c)** Positive **e)** Positive 0621C **a)** Negative **aa)** Negative **b)** Positive **c)** Negative **e)** Positive 0621D **a)** Negative **aa)** Negative **b)** Negative **c)** Negative **e)** Positive 0621E **a)** Negative **aa)** Negative **b)** Positive **c)** Negative **e)** Positive 0621F **a)** Negative **aa)** Negative **b)** Positive **c)** Negative **e)** Negative 0621H **a)** Negative **aa)** Negative **b)** Positive **c)** Negative **e)** Positive (continued overleaf)

Charging Methodology Relevant Objective (continued):	0621J **a)** Negative **aa)** Negative **b)** Positive **c)** Negative **e)** Positive 0621K **a)** Negative **aa)** Negative **b)** Positive **c)** None **e)** Positive 0621L **a)** Negative **aa)** Negative **b)** Positive **c)** Negative **e)** Positive

Reason for support/opposition and preference and comments on Relevant Objectives

Introduction

EDFT relied upon the outputs posted on the JO website to follow the modification development process. Based on the materials produced, it is clear that the process was not smooth and the proliferation of modification proposals suggests that consensus was not achieved, as originally hoped. The submission of proposals relatively late in the process has meant that supporting analysis has been delayed, and we note changed during the consultation period, meaning that industry had very limited time to consider the impacts of the proposals. We are particularly concerned that National Grid ran analysis workshops after the workgroup report had been sent out for consultation and that errors were discovered in both the models and the analysis workbooks with less than two weeks of the consultation window left to run.

Given the potential magnitude of the changes to the NTS charging regime and the accompanying impacts on Users and customers we are not satisfied that industry has been given sufficient time to adequately assess the proposals and recommends that, as a minimum Ofgem revisits the analysis in its Impact Assessment, or the Modification Panel directs that the workgroup report should be re-consulted upon.

Comments on the Modification Proposals

One of the main argument in favour of modifying the current methodology is avoiding volatility and unpredictability in capacity pricing for revenue recovery purposes. Given the reduced timeframe allowed for such a significant change in charging framework, we consider imperative that no matter of which modification proposal is eventually implemented a continuous process of improvement and correction of defects is ensured going forward.

0621 (Oppose)

We are concerned that the application of the CWD methodology coupled with a move towards full capacity pricing can be regarded as cost reflective and positive for competition. A critique of CWD is provided in a later section of this response.

In short, the distortions created by CWD (average distance assumption) are magnified by the adoption of full capacity pricing (see entry and exit price changes contained within the analysis workbooks). In addition, the reliance on accurate capacity forecasting at each and every point to determine capacity charges may result in further distortions and certain Users/customers making excessive contributions to allowed revenues. The socialisation of revenue under-recoveries via capacity charges exacerbates the perceived cross-subsidisation, often levelled at the current regime.

The effective removal of discounts for short term firm and interruptible capacity products has not been justified on a cost reflective basis. The price of these services should be based on the cost of provision as any other charge will result in a cross-subsidy between users of the network. We see no basis for basing the price of interruptible products on the probability of interruption, more reasonably we would expect prices to be based on the short run marginal cost of providing the service to Users.

0621 does not provide for a solution for an optional charge in the enduring period. CWD can result at times in high exit charges for points located close to entry points. In such circumstances an inefficient bypass of the NTS can occur. We consider this modification does not ensure an appropriate alternative mechanism to remedy to this anomaly.

Finally, we believe that the application of a 50% discount for storage users is not cost reflective and will distort competition. The costs (and benefits) of storage have been more accurately determined in the analysis supporting Mod 621A

0621A (Comments)

The same criticisms of Mod 621 apply to this proposal with the exception that the application of an 86% at storage points more appropriately reflects the relevant costs (and benefits) on the network.

0621B (Qualified Support)

The facts that this proposal employs CWD as the RPM means that a number of the criticisms applied to Mod 621 apply here.

There are, however, some marked differences:

- The use of obligated capacity levels for determining FCC will result in “depressed” capacity prices, with a greater emphasis on commodity charges for revenue recovery purposes. This dilutes the geographical peculiarities particular to CWD and leads to a socialisation of costs via a unit pay as flow charge. Based on our observations around the various RPMs (see below) EDFT contends that the proposal is pro-competition and at least as cost-reflective as any of the other proposals.

- Where a network is unconstrained, such as the NTS, a capacity charge which has linkage with cost drivers (capacity and distance) is suitable, however that linkage should not be over-emphasised for the purposes of delivering investment signals. In this case the use of a commodity charge is appropriate.

- The application of an 86% discount for storage ensures charges are cost reflective and facilitate competition

0621C (Comments)

The establishment of an OCC product which is consistent with the CWD model and capacity booking driven revenue recovery allows for certainty and stability, both of which are positive for competition. In addition, the proposal properly accounts for the costs/benefits applicable to storage facilities.

We are, however, unable to provide full support for this proposal as we consider additional analysis would be needed to properly assess the full scope of its impacts.

0621D (Oppose)

There is no justification for dampening the distance impact in the CWD model on the basis proposed (see later comments).

The removal of OCC will have negative outcomes for customers and will result in the inefficient by-pass of the NTS to the cost of all Users and customers.

The proposal will fail all of the objectives with the possible exception of being complaint with EU law.

0621E (Oppose)

The same criticisms of Mod 621 apply to this proposal.

0621F (Comment)

Some of the criticisms directed at Mod 621 also apply to this proposal. In particular the 50% discount proposed for storage as we noted earlier is inadequate. We however understand that flows across IPs should be facilitated and acknowledge that the intention of the proposal is consistent with this aspiration. Notwithstanding this, it is to be ascertained whether it achieves compliance with EU Law since the proposed discount at bi-directional interconnectors may only apply in the case that the GB is considered energy isolated.

0621H (Oppose)

The same criticisms of Mod 621 apply to this proposal.

Further, there is no basis for discriminating in favour of historical contracts for the purposes of revenue recovery charges. Where revenue recovery charges are applied to such contracts at present there is no justification for excluding them in future.

0621J (Oppose)

Postage Stamp is a flawed methodology. It assumes that there are no cost drivers in relation to the use of a pipeline network and that all charges, at all entry points and all exit points should be the same. Over time, the NTS has been extended to include more remote entry and exit points and logically the cost of bringing gas in or taking out of these locations should make a greater contribution to historical costs. These comments should be read in conjunction with our later critique of the CWD, noting that EDFT supports some degree of geographical pricing, but this should not be to the detriment of competition.

0621K (Comments)

The proposal is similar to Mod 621A and for the same reason we see merit in certain aspects. The application of a 100% discount for off-peak capacity may be reasonable on a cost reflective basis, however, there is insufficient consideration of whether this discriminates in favour of

storage users. Certainly, as we have stated, we are not convinced that the general discount of 10% provided for all off peak interruptible capacity is cost reflective and believe that further work needs to be undertaken to ascertain an appropriate price for this service.

0621L (Oppose)

The same criticisms on Mod 621 apply to this proposal.

Implementation: *What lead-time do you wish to see prior to implementation and why? Please specify which Modification if you are highlighting any issues.*

We require a minimum notice period of 150 days to ensure that the market can respond to what will be material changes to the NTS charging regime

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

Administrative costs in adapting to the transition to a new regime.

Legal Text: *Are you satisfied that the legal text will deliver the intent of the Solution? Please specify which Modification if you are highlighting any issues.*

No comment

Modification Panel Members have requested that the following questions are addressed: *Please specify which Modification your views relate to.*

1. *Do you believe there are specific issues that should be considered by Ofgem's Regulatory Impact Assessment?*

   The IA will need to focus on:

   - The impacts of moving from LRMC to CWD/Postage Stamp RPM, in particular on customers in certain locations e.g. North v South, NTS v DN and cross border trade

   - The impacts of effectively equalising the reserve prices of all capacity products via changes to multipliers/discounts on customers and cross-border trade

   - The impacts of the proposed changes to OCC on existing Users of OCC and customers (wider consideration of economic impacts) as well as cross-border trade

   - The specific impacts on gas storage of increasing the cost-burden on the Users and operators of these facilities. Consideration should be given to wider impacts of reduced cycling, or possible closure/non-development of facilities.

2. *The rationale in the report for having an interim period and using the obligated capacity as the Forecasted Contracted Capacity (FCC) is to avoid significant changes to charges and have a period to understand how booking behaviour changes. How does this compare to having two structural changes to charges (one at the start of the interim period and another at the enduring period)?*

   EDFT does not support the implementation of an "enduring regime" and prefers the arrangements set out in Mod 621B which for all intents and purposes recommends the extension of the "interim period" *ad infinitum*.

3. *What (if any) consequences do you see from 'interim contracts' being allocated at QSEC and AMSEC auctions in 2019 given the timings of these auctions in the UNC and possible date of Ofgem decision on UNC621? What options are there to deal with these consequences and what impact would these options have?*

   The open-endedness of the commitment to categorise future bookings as "historical" up to the point at which Ofgem makes its decision (or end of May at the latest) is wholly unsatisfactory. The market needs certainty in the regulatory framework if it is to function effectively and deliver cost efficient services to customers.

   In order to foster a stable regulatory environment we recommend that steps should be taken to exclude any purchases of QSEC or AMSEC capacity from acquiring "historical status" at such time as Ofgem publishes its IA. In its IA Ofgem is expected to provide a "minded to decision" and at the same time should instruct National Grid to raise a modification proposal which limits "historical" capacity to that which has been acquired up the date of the publication of the IA.

4. *Do you consider the proposals to be compliant with relevant legally binding decisions of the European Commission and/or the Agency for the Co-Operation of Energy Regulators?*

   Yes, EDFT is of the view that the EU Tariff Code can be interpreted in a manner which permits implementation of any of the modification proposals. Ultimately, GB should endeavour to introduce changes to the NTS Charging Regime which comply with the GB relevant objectives and ultimately best serve the interests of GB Users and customers. Our concerns with modification 621F should be noted.

5. *In what way do you consider the reference price methodologies proposed (Capacity Weighted Distance (CWD), CWD using square root of distance and Postage Stamp) to be cost reflective and meet the criteria in Article 7 of TAR?*

   Achieving cost reflectivity in charges, which are ultimately subject to the achievement of an allowed revenue, is a difficult task and subjective in its assessment. Certainly, CWD is regarded as the default or counterfactual methodology in the EU Tariff Code and on this basis implies that it is regarded as sufficiently cost reflective to comply with Article 7.

   Before assessing the three proposed methodologies it is worth considering the degree to which the current LRMC methodology can be regarded as cost reflective.

   Cost reflectivity and the current LRMC methodology

   LRMC is based on the economic principle that charges are cost reflective when they are based on Long Run Marginal Costs. The LRMCs are derived by assuming notional investments in the NTS. The marginal distances which underpin the derivation of LRMCs are in turn dependent upon flow scenarios, which are updated on an annual basis and subject to a forecast 1 in 20 of peak day demand and a fixed supply merit order. At exit, LRMCs are adjusted (scaled) to recover the ascribed allowed revenue, whereas at entry the "raw" LRMC prices are applied (following adjustment in accordance with the expansion factor) and effectively scaled up through the application of a TO commodity charge applied on the basis of flows (noting that the level of scaling up depends upon the load factor or utilization of the capacity acquired).

   It is clear that the LRMC model is based on a number of assumptions and is heavily impacted by changing demand and supply forecasts, which in turn result in seismic shifts in prices, year on year. In combination with the need to collect allowed revenue, it is arguable whether the prices which are derived in this manner are cost reflective, in

particular where no investment is forthcoming and the NTS is essentially static, if not shrinking. In addition, given TO charges are intended to reflect the capital costs associated with delivering a pipeline network, it is difficult to align a relatively stable cost base with shifting prices at each entry and exit point.

It is our view that the current model is no more or less cost reflective than any of those proposed, as in a static network where investment is not required, charges should tend to zero. Because of the need to recover allowed revenue, the current regime is little more than a revenue allocation methodology which is based on fluctuating and questionable supply scenarios.

Cost reflectivity and the CWD methodology

The CWD methodology allows for the allocation of historical and current costs associated with the delivery of the NTS. Based on the reasonable assumption that the NTS is static, or in decline, the methodology seeks to ensure that all Users of the system make a contribution to the provision of the NTS on the basis of distance and capacity (the two cost drivers). Unlike LRMC it ignores flows and does not attempt to identify any constraints which would be overcome by system reinforcement.

The greatest departure from LRMC is that, absent of any flow modelling, the innate assumption is that all gas which enters the system can be delivered to all exit points and likewise all exit points can receive gas from any entry point. These are unrealistic assumptions which result in charges at points at the extremities of the network being relatively high. This is particularly problematic in GB where, unlike most other markets, there are numerous entry points scattered across the region. Certainly, it is counterintuitive to assume that gas which is injected into the network at St Fergus or Milford Haven will be consumed anywhere further than by local customers.

Notwithstanding this observation, given the limitations identified with the LRMC methodology it is difficult to determine that this approach is any less cost reflective than the current regime.

Cost reflectivity and the Postage Stamp methodology

Postage Stamp removes the distance element of CWD and applies equivalent charges at entry and exit points (independently). In short, the same charge is applied to all Users of the system irrespective of where gas is delivered or offtaken. This could be regarded as the most basic form of cost allocation without any reference to underlying cost drivers. In this sense it cannot be regarded as cost reflective and will have the biggest impact on the distribution of costs across Users and customers.

Given the use CWD using square root of distances sits between pure CWD and postage stamp and that the application of the distances is entirely arbitrary we would argue that it is probably the least cost reflective of any of the proposed methodologies

6. *The proposals have different combinations of specific capacity discounts for storage sites and bilateral interconnection points. In what way do you consider the different combinations facilitate effective competition between gas shippers and gas suppliers?*

The proposals which stipulate the minimum 50% discount for storage should be regarded as providing nothing more than a recognition that a lower discount would result in double charging of storage users.

The analysis produced to support the application of an 86% discount correctly identifies the real costs which should be assigned to storage users. Where costs (and benefits) are more accurately defined and applied it will have a positive effect on competition.

There might be some logic behind allowing interconnectors to benefit from a discount in that we agree that flows across IPs should be facilitated. However, the different physical attributes of interconnectors, where gas enters and leaves the GB network suggests that they should not necessarily be subject to the same level of discount as storage

Are there any errors or omissions in this Modification Report that you think should be taken into account? *Include details of any impacts/costs to your organisation that are directly related to this.*

EDFT is disappointed that the analysis carried out in support of the report was finalised at the end of the development process and too late to be incorporated in the report.

As a result of the timing of the analysis, industry was not able to review and discuss the outputs until after the consultation window had opened through the two National Grid workshops. Following these workshops, errors were identified which were not rectified by National Grid until 13 June. We are concerned that industry has not been presented with sufficient time to digest the new information and for this reason responses are likely to be more subjective than planned.

In addition, we note that very little work has been undertaken to assess the impacts of the proposed changes to OCC. Without any analysis, it is difficult to properly assess the proposals against the relevant objectives. An analysis of the possible capacity booking behaviours of shippers in the absence of OCC should be carried out. This should take into consideration impacts on current contractual arrangements, and how they may impact security of supply.

We note that all but 0621B and 0621C remove the option OCC in the enduring period. EDF Trading would strongly encourage rapid development of an enduring OCC solution to ensure that in the interim and longer term customers are cognisant of future cost burdens and are able to assess bypass options. Where there remains “a tariff vacuum” economic investment decisions cannot be taken resulting in sub-optimal outcomes. As a principle, we consider the concept of short-hauling as a legitimate tool; providing an appropriate discount to shippers (and customers) in cases where a private pipeline is a realistic alternative due to geographical proximity between entry and exit points.

This puts greater emphasis on the Impact Assessment. The analysis presented in the IA will need to plug any gaps in the analysis as well as carry out wider assessments on those areas not covered in the report.

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