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:	Kirsty Ingham
Organisation:	ESB
Date of Representation:	22 June 2018
Support or oppose implementation?	0621 - Comments 0621A - Comments 0621B - Comments 0621C - Comments 0621D - Oppose 0621E - Comments 0621F - Oppose 0621H - Comments 0621J - Comments 0621K - Oppose 0621L - Comments
Expression of Preference:	

Standard Relevant Objective:	0621 **a)** Negative **c)** Negative **d)** Negative **g)** 0621A **a)** Negative **c)** Negative **d)** Negative **g)** 0621B **a)** Positive **c)** Negative **d)** Negative **g)** 0621C **a)** Positive (? Insufficient analysis on the inefficient bypass proposal) **c)** Negative **d)** Negative **g)** 0621D **a)** Negative **c)** Negative **d)** Negative **g)** 0621E **a)** Negative **c)** Negative **d)** Negative **g)** 0621F **a)** Negative **c)** Negative **d)** Negative **g)** 0621H **a)** Negative **c)** Negative **d)** Negative **g)** 0621J **a)** Negative **c)** Negative **d)** Negative **g)** 0621K **a)** Negative **c)** Negative **d)** Negative **g)** 0621L **a)** Negative **c)** Positive **d)** Negative **g)**

Charging Methodology Relevant Objective:	0621 **a)** Negative **aa)** Negative **b)** Positive **c)** Negative **e)** 0621A **a)** Negative **aa)** Negative **b)** Positive **c)** Negative **e)** 0621B **a)** Negative **aa)** Negative **b)** Positive **c)** Negative **e)** 0621C **a)** Negative **aa)** Negative **b)** Positive **c)** Negative **e)** 0621D **a)** Negative **aa)** Negative **b)** Positive **c)** Negative **e)** 0621E **a)** Negative **aa)** Negative **b)** Positive **c)** Negative **e)** 0621F **a)** Negative **aa)** Negative **b)** Positive **c)** Negative **e)** 0621H **a)** Negative **aa)** Negative **b)** Positive **c)** Negative **e)** (continued overleaf)

Charging Methodology Relevant Objective (continued):	0621J **a)** Negative **aa)** Negative **b)** Positive **c)** Negative **e)** 0621K **a)** Negative **aa)** Negative **b)** Positive **c)** Negative **e)** 0621L **a)** Negative **aa)** Negative **b)** Positive **c)** Negative **e)**

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

Overall comments

We recognise and are grateful to the Joint Office for the considerable efforts taken to facilitate this methodology review as a Modification process. It is clear, though, that a Modification process has not been the governance approach best suited to the task: the quantum of alternatives stems from the need for another full proposal to be tabled in order for review and analysis of a single sensitivity or scenario; this caused inefficiency in use of time and effort, leading to delay. Each set of analysis when provided for discussion resulted in more questions and areas for exploration, but there was no time to pursue many of these, and other questions have emerged only since gaining access to models at consultation stage. Revisions to spreadsheets ten days prior to deadline is an indicator of the time pressures and lack of in depth review of the proposals. Allowing the 0636 Mod process to run concurrently exacerbated the difficulties for all concerned and has deflected focus away from 0621.

The sheer number of alternatives and complexity of models has made it very difficult for industry to conduct its review and assess potential impacts. All proposals take 0621 as their basis, adjusting many or few elements to meet different, but important, objectives. This means that there has been no rational process to develop a solution which can best meet the needs of consumers and network users alike (i.e. identification of issues and their root causes from current, options for amendment and redesign, analysis and simulations, assessment against prioritised objectives, development of draft solution and counterfactual for consultation and RIA to justify the selection). Parties responding to this consultation can highlight strengths and weaknesses of each proposal, but cannot assess the impact of mixing and matching elements from all of the listed alternatives. Picking a preferred option is therefore very difficult. “Least worst” should not be considered as adequate, the consequences for investment and consumers are too large. In this case, prioritisation of EU compliance over the most pragmatic tariffication approach for GB may have been misplaced. At this point there is an opportunity to realign this review and the process in order to ensure that an enduring and well-considered tariff methodology can be selected, ensuring the best solution for market participants and consumers of energy (this being gas and power).

The CWD approach is a method of cost allocation, with the allocations based on the shape of the pipeline network. This is in turn driven by the geographical shape of the land mass and the history of supply and demand locations, which may not reflect the future; the inclusion of points in the modelling which are not operational does not reflect the present. The shape of GB and history of the network is not helpful for CWD as an approach: the distance variance between points on the network can be very large and some points at the extremes have large capacity. These effects were understood relatively late in the workgroup's review. TAR Art. 8, c) and d) refer to relevant flow scenarios as inputs to the calculation, i.e. taking into account only entry:exit combinations that gas flows or would rationally flow between. This analysis was not pursued, although was suggested at workgroup, and may mitigate the distortional impacts.

Under CWD, distance is intended as a cost driver, however, under an Entry:Exit matrix of charges this is hard to represent without the result of locational distortions. The old point to point charging models attempted to address cost reflectivity of distance more accurately, but do not facilitate trading and so were phased out. CWD uses distance as a variable in the calculation, not directly to reflect the cost of providing transmission services. We agree with work conducted by Frontier Economics for Energy UK which reached the conclusion that CWD is less cost-reflective than LRMC.

The aims of predictability and stability can only be met when the inputs to the model support them. The use of a booking forecast as FCC for the tariff calculation from GY 2021/22 is of concern: National Grid has stated that the transition period of two years will enable them to develop sufficient insight of changed behaviours to make accurate forecasts. This seems unrealistic. Shippers themselves are unlikely to have developed a consistent *changed behaviour* in this period of time. National Grid's methodology is also as yet undefined. The presented analysis assumes perfect foresight, which is caveated, but must be recognised as a weakness in drawing any conclusions from the illustrative modelling.

The change in capacity:commodity split to 100:0 for all points from GY 2021/22 will redistribute cost to low load factor users. The publication of the analysis results as tariffs in commoditised form and the lack of review of the impact on different types of end-user means this is not made clear. There will be a significant cost impact, for example, on electricity peaking plant, which are anticipated to be critical to security of supply in the power sector as penetration of renewables continues to grow.

Reduction of the discount for Off-peak (interruptible) capacity to 10% from GY 2019/20 will also have a significant cost impact on power generation, which as a sector uses this product widely. This additional cost will be included in Capacity Market bids and be passed through to electricity end-users. The representation in the analysis provided of the change from current to GY 2019/20 does not show the whole picture. Transitional steps for introduction of any change to this product would be advisable.

The revision of the OCC with introduction of an arbitrary 60 km distance cap is also a concern. The distance cap was not based on assessment of cost calculations for a rational project for efficient bypass, but on the list of distances currently using the OCC, picking a threshold where a gap was present. This evidence does not seem adequate in the circumstances. The lack of a solution for the enduring period is also of concern.

Calculations net of revenue from existing contracts at Entry creates a very large differential in tariffs between historical and newly purchased capacity. This is detrimental for competition and a barrier to entry. There will be instability of tariffs at these points due to the ongoing expiry of the historical contracts over time; in a sense, until all the contracts have expired, there is still a transition period.

0621A

As 0621 above.

Further objective analysis for justification of the proposed 86% discount for storage (or another level) should be carried out.

0621B

As 0621/0621A above.

Retaining commodity charging for revenue recovery is preferable to moving to 100% capacity charging as it is less distortive.

0621C

As 0621/0621A above.

Treating IP Entry and Exit points differently to one another for revenue recovery appears not to be TAR compliant.

The proposal of an enduring solution for inefficient bypass based on capacity weighted distance was not subject to analysis to understand its impact.

0621D

As 0621/0621A above. The use of square route of distance mitigates the locational distortions to a degree, but the use of relevant flows would likely be a more justified approach.

The removal of any solution for inefficient bypass on the transmission system would have a negative effect on efficient and economic operations of the system.

0621E

As 0621 above.

The extension to the transition period to provide stability of charges for generators participating in the Capacity Market T-4 auctions is positive for the power sector (the power sector being an adjacent market, in which all gas consumers participate), facilitating more informed bidding and competition in the auctions. The period could be extended further or made conditional to support this aim, given uncertainties on auction timings and implementation of this process.

0621F

As 0621 above.

Further objective analysis of the use of bidirectional interconnection and international storage to serve GB end-users is needed to justify the proposal for a discount.

0621H

As 0621 above.

The proposed differential treatment of holders of existing contracts for revenue recovery at Entry may cause distortions and negative impact on competition.

0621J

As 0621A above (storage discount).

The use of a postalised tariff is not cost-reflective and may lead to inefficiency. Tariffs at IPs are higher than at Non-IPs during the transition period, due to the use of capacity-based revenue recovery. This does not seem consistent with the postage stamp concept.

0621K

As 0621/0621A above.

The proposal of 100% Off-peak discount at storage points is not justified.

0621L

As 0621 above.

This proposal would remove the impact on Entry point tariffs from expiry of existing contracts over time and reduce distortion between existing and new contract holders. It is therefore positive for competition.

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

As much notice as possible is needed in order to make systems changes and assess business impacts. The Capacity Market auction due to take place in Q1 2019 is front of mind, therefore early decision making and extension of the transition period are both required for any changes.

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

For all options, ESB would need to review impacts on internal systems, commercial arrangements and operations.

Generically for the power sector without quantifying any costs ESB would face, the change in discount for Off-peak capacity will increase costs significantly. It is possible that for some plant, combined with the move to 100:0 capacity:commodity split, this additional cost could be critical to continued operations.

ESB has operations in Northern Ireland and the Republic of Ireland. The wholesale price of gas on the island of Ireland is heavily influenced by the GB wholesale gas price (NBP) and the cost of transportation of gas. From the National Grid models, the increase in gas prices based on the increase in the Moffat Exit tariff alone may be significant and this will be passed through to end-users of both gas and electricity. We also anticipate impact on the GB wholesale NBP price itself, which could further increase gas and power prices on the island of Ireland.

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.*

We have not reviewed the full legal text.

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

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

   As a participant in the gas and power sectors and as a large user on the system, ESB would welcome an approach that considers all of the elements proposed that may have unintended consequences (including but not limited to the use of a reduced off-peak discount, the arbitrary selection of the OCC cap, the use of distance as a variable only and not as a reflection of cost imposed). This will allow the industry and the regulator to ensure that the correct tariff exists and can be obtained into the future, and also that the system provides the right products and signals to existing and new users. To do otherwise would result in the outcome not being fit for purpose.

   Whole system impacts (defined as networks and wholesale markets, and across markets that are interoperable) should be part of the RIA, including for the entire United Kingdom. Cross-border impacts to other EU Member States would be desirable, including the entire island of Ireland. TAR's aims include supporting security of supply, inter alia via infrastructure developed for the purpose of ending the isolation of Member States in respect of their gas transmission system, and avoiding distortion to cross-border trade. There is a need to consider these effects of neighbouring markets and minimise any negative consequences.

   Specifically, cross-sectoral impacts on the power sector must be included, taking into account the impacts of change based on actual capacity products purchased, load factors and security of supply.

Ofgem requested that the following questions be included as part of the consultation. Panel agreed to include these:

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)?***

   It clearly does not avoid having two significant changes in charges, for some points the indicative models show wide differentials and see-saw effects between transition and enduring periods. The change to 100:0 capacity:commodity split will vary in its significance depending on the type of user, but in some cases the impact will be large.

   The concept of two years being sufficient time for Shippers to make consistent and considered changes to their booking behavior is unrealistic in itself, aside from National Grid being able to produce an accurate forecast based on this information. The start of the enduring period is likely to cause further major adjustments to bookings as outlined above. Expiry of existing contracts over time adds to the uncertainty.

   A phased introduction of any enduring methodology (e.g. introducing a glide path to change the Offpeak capacity discount and capacity:commodity split gradually) would avoid step changes.

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?

If future differential treatment of existing Entry contracts is considered favourable by indication ahead of the auction, and they are still counted as interim, it will clearly influence purchasing strategies in this final auction where capacity can qualify as existing. On the other hand, a lack of information and uncertainty could also influence participation. It seems that, at this stage of the process – unless there is significant realignment and redesign – and certainly by early 2019, there should be enough information available to purchasers to have a view of the future regime. The contracts can then no longer be seen as interim or existing, as there is no or little argument about not understanding the future implications and therefore requiring specific treatment.

Existing Exit capacity, with floating prices, is not subject to such possible issues or benefits, but may be returned provided notice is given in a specific time window.

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?***

   There is much uncertainty about compliance and interpretation of the Regulation, as discussed in the workgroup sessions (see Energy UK materials presented).

   As mentioned above, being pragmatic rather than dogmatic should be the preferred course of action. Prioritisation of EU compliance should be weighed against implementing a better solution for GB and taking sufficient, and necessary, time to do so. This may be facilitated by applying for dispensation from the legislation at a European level as we have significant evidence to prove the intent to meet those obligations.

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?***

   The methodologies listed are cost allocation methods and are not reflective of "*actual costs* […] *for provision of transmission services*", apart from the fact that they recover the pot of allowed revenue.

   Under c), it appears that most proposals fail the cost allocation assessment.

   Under e), the effects on cross-border trade cannot be fully anticipated, although some impacts on flows to, security of supply in and gas and power prices on the island of Ireland can be foreseen.

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?***

   TAR recognises that discounts at storage should be applied, recommending a 50% minimum. IPs are mentioned as part of a homogenous group which could be considered for discounts, especially when connecting to an otherwise isolated network. As mentioned above, we would like to see further objective justification for larger discounts at storage and any discount at IPs. The lack of physical holding of gas in an IP pipeline vastly reduces its security of supply potential benefit.

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.*

Omissions:

- Consideration of relevant flows for CWD analysis.

- Review of a base case proposal, which would seek to amend the current system minimally with the intention of addressing the issues identified as problematic and comply/justify non-compliance with TAR.

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

None.

We refer to Frontier Economics paper for Energy UK, *Gas Transmission Charging Review Analysis*, available at this link:

https://www.energy-uk.org.uk/publication.html?task=file.download&id=6680