OIL&GAS UK

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:	William Webster
Organisation:	Oil and Gas UK
Date of Representation:	22 June 2018
Support or oppose implementation?	0621 - Comments 0621A - Comments 0621B - Qualified Support 0621C – Qualified Support 0621D - Comments 0621E - Comments 0621F – Oppose 0621H – Comments 0621J – Qualified Support 0621K - Oppose 0621L - Comments
Expression of Preference:	See discussion below

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

0621

This modification has some positive elements in that it replaces the obsolete LRMC methodology and provides for compliance with the TAR network code. The proposal also includes better recognition of the status of historical long-term bookings given that the enduring regime will reduce the extent of cost recovery through the commodity charge especially in the enduring

scheme based on FCC. Many of our members consider the current elevated level of the commodity charge has had an undue negative effect on holders of historical bookings. However, some members also have concerns about the use of the CWD model as a long-term basis for charging. The CWD model is questionable from the perspective of cost reflectivity given the current and future unpredictable nature of flows in the transmission network. Finally, the locational signals provided by the distance-based regime do not provide sufficient support to the need for diverse sources of supply for consumers and the government policy objective of maximising economic recovery from the UKCS (MERUK).

0621A

In addition to the comments provided on Mod 0621, which is the basis for the alternate: this modification also proposes an additional discount for users of embedded storage on the basis that the minimum 50% discount does not fully remove the implied double charge made to parties using flexible storage assets. To the extent that this adjustment has a minimal impact on other charges, a higher discount for storage users could be a feature of the charging regime to avoid undue charges falling on particular network users. Having said that, it is also the case that users of storage may be able to manage their exposure to this potential double charging by purchasing flexible capacity products on, for example, a daily basis. Furthermore, it would not be appropriate for users of storage to have discounted charges for any other reason (e.g. perceived security of supply or flexibility benefits of "storage"). This would create unfair competition between different sources of flexibility which should be largely remunerated through the wholesale market.

0621B

This alternate, as well as retaining the 86% storage discount from 0621A also envisages retaining Obligated Capacity (OC) in the CWD calculation for the enduring solution rather than being based on NGCs forecast of contracted capacity (FCC). The positive impact of this alternate is that it moderates the impact of the CWD method on peripheral points. It is therefore preferable to 0621 for that reason. At the same time, the modification would retain a significant shortfall to be retained from a uniform commodity charge on an ongoing basis and partially continues the status quo. This alternate also retains the optional charge short haul commodity charge in the enduring regime which is considered to be a positive element. However, the retention of a commodity charge for revenue recovery continues, to some extent, the undue negative impact of these charges on holders of historical bookings compared to the enduring solution in 0621.

This alternate has qualified support from Oil and Gas UK.

0621C

This alternate is also based on 0621 and has the same negative impact arising from the application of the CWD mechanism. However, it also puts forward a capacity-based enduring short haul tariff which could help mitigate the impact of the distance related charges for some users and ensure that gas flows to GB are not adversely affected.[1] The alternate also would prevent any capacity-based revenue recovery charges being applied to holders of historical bookings which some of our members consider to be a positive feature.

This alternate has qualified support from Oil and Gas UK.

[1] It is understood that Modification 0653 by the same proposer also includes the capacity based short haul proposal and we support this when compared against Modification 0636 and the alternates submitted under that process.

0621D

The alternate is based on a variant of the CWD model working from the square root of distance. It is therefore preferable to 0621 in that the locational impact of the changes would be moderated. However, the other element of this alternate is the early removal of the short haul optional tariff. This offsets the potential benefits from the modification of the CWD methodology.

0621E

This alternate is largely based on 0621 with the main difference being the length of the transition period for exit charges. As for 621C the alternate also prevents capacity-based revenue recovery charges being applied to holders of historical bookings which some of our members see as a positive feature. But, overall, the long-term impact is not materially different to 0621.

0621F

This modification proposes that any discount applied to storage should be recreated for shippers that are deemed to have used continental storage via the use of interconnectors. This modification, however, is not necessary, particularly for users of seasonal storage, which will be able to tailor their booking strategy to the predicted use of the network and thereby manage their costs. The modification also risks discrimination between different sources of summer-winter swing which is also, to some extent, provided by both UKCS production and LNG imports. The proposed alternate is therefore not consistent with the objectives relating to competition.

This alternate is opposed by Oil and Gas UK.

0621H

The protection proposed to holders of historic bookings in this alternate, by excluding these entirely from revenue recovery, is seen by some of our members as a more positive feature which makes it a preferable solution. In particular, the proposal would both unwind the negative impact of the current commodity charges on long term bookings and lead to a more equitable distribution of costs between long term and short-term bookings. Meanwhile other members suggest this could have a distortionary impact as National Grid would have to recover their revenue from a smaller number of players, increasing tariffs for other network users. At the same time, 0621H is still largely based on the 0621 methodology and has some of the same negative features in terms of the impact of CWD at particular entry points.

0621J

This alternate is based on a postalised capacity-based charge rather than CWD. Many of our members consider that this is a more predictable and stable basis for charging for the future operation of the network without significant expected capacity constraints (particularly for entry). This means that cost allocation based on inferred distance is no longer necessary. The postalised model also corresponds better to the objectives related to network operation and security of supply given that it charges an equal entry fee to all potential sources of supply to the market. The main drawback identified is the potential distributional impact between different entry points.

This alternate modification has qualified support by Oil and Gas UK.

0621K

This alternate, based on the 0621 modification, as well as including the proposed 86% storage user discount from 0621A, also sets out a 100% discount for users of interruptible capacity at storage entry and exit points. The argument provided by the proposer is that the short run incremental cost of providing such a service is zero. In addition, the proposer suggests that the

benefits to National Grid outweigh the costs. Neither of these provide sufficient justification of the proposal given that a large element of the need to redesign the tariff methodology is how to recover fixed costs of a network that is non-constrained across all network users. Existing discounts for interruptible capacity are being substantially reduced. Likewise, the general argument that certain storage options are of particular benefit to the system or to NGC in its operation of the system are not well defined as noted in the comments on 0621A and 0621F.

This alternate modification is opposed by Oil and Gas UK.

0621L

This alternate is generally consistent with 0621 other than the proposed inputs to be used to calculate the CWD charges. Including existing contracts in National Grid's calculation of the reference price, as proposed in 0621L, means National Grid will recover their allowed revenue from a greater volume of capacity bookings, rather than only future bookings. The consequential impact is that shippers booking future capacity will pay relatively less, compared to National Grid's proposal. This proposal would increase tariffs for network users that have booked existing long-term capacity on the back of previous investment decisions. For this reason, some members felt that this proposal would unduly discriminate against existing contract holders.

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

No comments.

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

Not applicable to trade association. Please see submissions from individual companies.

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 comments

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?*

   In general, it is expected that Ofgem's Impact Assessment will encompass both quantitative modelling as well as building on the more qualitative assessment carried out by the workgroup.

   The Infrastructure Act 2015 created a new framework for the offshore oil and gas sector by creating an independent regulator, the Oil and Gas Authority, and confirming the overarching primary objective on operators to act in a way consistent with maximising economic recovery of the resources of the UK Continental Shelf ("the MERUK Objective"). These obligations are codified in the MERUK Strategy which imposes detailed obligations on operators.

Although Ofgem has its own statutory duties, consideration needs to be given to the alignment of the regulatory framework between the upstream and downstream elements of the UK gas market. These are not inconsistent, since it is in the interests of consumers to have available a wide range of sources of gas, including indigenous production. The impact assessment framework must therefore assess the impact of charging regimes on the central government objective of MERUK and the benefits this represented in terms of maintaining competitive and diverse sources of supply for UK consumers. Any change to the charging regimes should not conflict with the central government objective of MERUK.

In summary, the impact assessment should therefore reflect the need for the UK to remain an attractive market for gas such that inflows from continental gas and LNG are supported, while also ensuring the UKCS is an attractive basin for continued investment.

Another issue that is also relevant is the impact of potentially higher costs for consumers in Scotland particularly from locational charges and the potential reduction in scope for the shorthaul charge in some of the alternates. An analysis of these distributional effects should to be included in Ofgem's Impact Assessment.

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)?*

   Any fundamental change to the charging structure is likely to affect how network users book capacity. For example, in response to the new regime, it might be expected that some network users will seek to book capacity to more accurately reflect expected flows of gas on a daily basis. However other users may put more value on the option to flow gas and maintain capacity purchases over seasonal or longer periods. To some extent these movements in booking behaviour are not easily predictable. Therefore, the use of OC during the transition period rather than an NGC forecast is understandable as this will make the charging outcome in the transition period more stable. As booking behaviour becomes clear, the charging regime should be able to iterate to a relatively stable state and this is probably preferable to having two structural 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?*

   The timing of the auctions in 2019 may create consequences in that shippers will have to make an assumption about the final approval of future charging regime when deciding whether and how to bid into the auctions. Depending on which alternate is agreed, any shipper contracting capacity may (or may not) see the capacity price change further vary based on the size of the revenue recovery element and the extent to which this is collected through adjustments to capacity prices. So instead of being a hedge against potential future scarcity of capacity, bidders will be partially taking a position against what they expect the final charging regime will be and this could lead to windfall gains and losses.

Whilst we understand the latest a decision can be made to comply with the EU Tariff Code is 31st May 2019, given the materiality of the changes, we would encourage a decision to be made earlier than this to give clarity to give industry participants further clarity, especially regarding the Quarterly System Entry Capacity (QSEC) auction in 2019. We would also welcome a "minded to" decision by Ofgem in late-2018 as part of the impact assessment consultation, to help provide clarity around potential proposal(s) that could be selected.

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?*

Each proposer has explained how they believe their alternate is consistent with the legal obligations in the network code. We have no reason to question their assessment and, in any case, interpretation of EU law is a matter for UK and European courts.

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?*

Article 7 of the TAR network code requires:

> "The reference price methodology shall comply with Article 13 of Regulation (EC) No 715/2009 and with the following requirements. It shall aim at:
>
> (a) enabling network users to reproduce the calculation of reference prices and their accurate forecast;
>
> (b) taking into account the actual costs incurred for the provision of transmission services considering the level of complexity of the transmission network;
>
> (c) ensuring non-discrimination and prevent undue cross-subsidisation including by taking into account the cost allocation assessments set out in Article 5;
>
> (d) ensuring that significant volume risk related particularly to transports across an entry-exit system is not assigned to final customers within that entry-exit system;
>
> (e) ensuring that the resulting reference prices do not distort cross-border trade."

Clearly there are a number of objectives set out in the network code which the reference methodology should "aim at". Each of the proposed methodologies will meet these criteria to a greater or lesser extent. It would be difficult to argue that any of the proposals was deliberately not aiming to meet those criteria.

With respect to criteria (b), cost reflectively, in the absence of significant constraints and where the direction of flows on the network are now increasingly unpredictable, a postalised methodology could be seen to best reflect the concept of cost-reflectivity. Increasingly, the transmission service provided by National Grid can be seen as a more generalised service to network users to manage their requirements in a wide range of different circumstances. This will encompass situations where, for example, flows in summer periods are largely N-S while during peak periods of demand flows might could frequently be in the opposite direction. Therefore, assigning costs based on the "average" distance flowed during the year as in CWD is misleading since the integrity of the system requires the option for the asset to be used either direction for a range of different volumes. In these circumstances there is no difference in avoided costs for different users at different entry and exit points.

More generally, maintaining some form of locational signal, even in the absence of significant congestion, could be appropriate to the extent that it was thought that:

- congestion or other costs such as maintenance can be avoided in future; and

- businesses are able to respond to a stable methodology in deciding which entry and exit points to use.

In view of this, there is not a particularly strong case for locational signals given that, unlike for the electricity generation sector, it is not possible for the sources of production to be moved around the network. Shippers using peripheral entry points such as St Fergus are not able to shift production which will be based on long term investment in UKCS. Higher charges at such points, whether cost reflective or not, are not consistent with the wider objective of maintain the UKCS as an attractive basin for investment. Looking forward, although entry capacity is not constrained, over the next 7 years 10 GW of coal will close and will need to be partially replaced by gas plant. Multiple PARCA applications are evidence of this and there may be future capacity constraints at exit. In view of this, some consideration is needed over whether locational signals are best embedded into the charging regime (as proposed by CWD) or result from the outcome of capacity auctions.

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?*

In general, the basic approach taken towards both multipliers and discounts in 0621 and most of the alternates is that multipliers are set at 1, and discounts are minimised. This approach is the correct starting point since discounts applied for one group of users will have an opposite impact on other users. Any amendments to the underlying methodology need to have a strong justification in terms of the charging methodology having an undue impact on charges for the remaining users. The burden of proof should therefore sit with the proposer in terms of evaluating the additional costs and explaining why the outcome is not appropriate.

For example, the proposer of Alternate 0621A has provided some evidence of the potential additional costs faced by users of flexible storage assets that are embedded in the UK transmission networks. This is less the case for other alternate proposing discounts which have based their argument around effective competition requiring the same charges for network users that are evaluated as providing “flexibility”.

However, this is not a sound basis for charging structures since all network users, to differing degrees, have some capacity for providing flexibility to the system including upstream production and demand side users. This flexibility should continue to be primarily rewarded from prices prevailing in wholesale markets. There is also scope for NGC, in its role as system operator, to provide additional signals to users via its within day market operations if additional flexibility is required. This approach is preferable to attempting to evaluate the degree and value of flexibly and embody that in the charging regime. Indeed, this is an impossible task since the value of flexibility is constantly changing depending on market conditions.

Therefore, even if an alternate containing a discount for storage operators is accepted, this does not necessarily imply that such discounts should be applied to interconnectors, or any other providers of flexibility, in order to avoid an impact on effective competition. This is because, if accepted, the discount to be applied to storage operators needs to be on the basis that such network users are at a particular undue disadvantage from the underlying methodology being used with the discount justified on the basis of correcting that disadvantage.

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

No Comments

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

About Oil and Gas UK

Oil & Gas UK is the leading representative organisation for the UK offshore oil and gas industry. Its membership comprises around 400 oil and gas producers and contractor companies right across the UK. The submission below provides further explanation of Oil and Gas UK position on the main parameters for the transmission review and is the basis for comments on the 0621 modification and the individual alternates.

Background to the review

The review of Gas Transmission charges is both a result of the EU Tariff Network Code ("TAR NC") as well as recognition that a number of features of the current charging scheme may no longer best reflect the current network conditions. Although the TAR NC applies only to interconnection points, Ofgem are expecting, and it is largely accepted, that a new charging structure should be applied to all relevant locations in the UK system.

The current charging regime, based on LRMC principles, was introduced when network capacity was constrained. Since gas demand has fallen significantly in the last ten years, the existence of such constraints has been significantly reduced. In addition, shippers have responded to the new situation by increasingly booking lower cost interruptible capacity. This has meant large increases in the postalised commodity charge that is used as a residual to ensure that NGC can recover its required revenues.

Summary of the Proposed Modification and Alternates

National Grid Gas ("NGG") as transmission system operator has a fundamental role in the review and the proposed changes are currently being discussed in the NTS Charging Methodology Forum ("NTSCMF") on the basis of a UNC Code Modification they have put forward (Mod 0621).

The main features of the NGC proposal are as follows.

> **Capacity Weighted Distance ("CWD")** is an alternative to LRMC and is proposed in the TAR NC, where the weighted average distance for each entry point (or cluster of entry points) to each exit point (or cluster of exit points) is determined. NGC utilises a distance matrix based on the physical network as of December 2015, with any relevant new points added in, and is based on the shortest physical path between points in an unconstrained network (where it is possible for capacity to flow from all NTS Entry Points to all NTS Exit points). The CWD methodology tends to be more transparent and stable with a more even distribution of NTS costs compared to LRMC.
>
> **Multipliers:** A multiplier is the factor applied to the RPM in order to calculate the reserve price for non-yearly standard capacity products. A multiplier less than 1 will mean a reduction to the reference price and a multiplier greater than 1 will mean an increase from the reference price. For modelling purposes, the NTSCMF sub group suggested that initially a simple approach should be followed where possible with a multiplier of 1 as a starting point, in order for users to evaluate the impact of adjusting the multiplier in the NGG model and providing feedback. This has been carried forward into the modification and all alternates.

Entry / Exit Split – The current RPM uses a 50:50 entry/exit split to attribute costs and revenues between entry and exit users, which are subsequently reconciled separately. This has been used for some time in GB in any case. Although none of the alternates have suggested revising the 50:50 split, this issue is likely to come up in future in relation to discussions on the fourth Gas Directive based on some of the EU "Quo Vadis" analysis.

Forecast Contracted Capacity ("FCC") – the CWD model required NGC to make a forecast FCC as inputs into the model. There are various ways that this can be done.

- FCC linked to Obligated Capacity (OC) Levels or Peak/Minimum Demand will tend to lead to a significant mismatch between actual bookings at each point versus forecast and there will be a fairly significant degree of under recovery from the basic methodology.

- The use of projections based on historical bookings or flows which are likely to improve the accuracy of the forecast and hence reduce variations in under/over recovery.

Moving to a new charging structure is, however, likely to affect the booking strategy of businesses. NGC propose a transition period whereby OC capacities will be used from 2019-21 and a projection based on actual bookings will be used from 2021. Given that OC capacity values are significantly higher (and this is the denominator for the calculation), there will be a significant need for revenue recovery during the interim period to 2021.

Historical multi-year capacity bookings – the charging regime has previously allowed for network users to enter into multi-year bookings with NGC with fixed capacity charges over the period in question. The TAR network code (Article 35) requires that these arrangements are maintained. Historical capacity holders would, however, still be required to pay any commodity charge necessary for revenue recovery. As already noted, in recent years the commodity charge has increase significantly as a result of network users booking low cost interruptible capacity and this has damaged the integrity of previous long term booking arrangements.

Interruptible Capacity – under the previous charging regime, users booking interruptible capacity could benefit from a reduction in capacity charges up to 100% for daily interruptible capacity. The TAR NC now requires the level of discount to be reflective of the probability of interruption. Given the situation of fewer capacity constraints NGC propose a much smaller discount of 10% maximum.

Optional Commodity Charge ("shorthaul") - The shorthaul tariff is currently available to all users and was originally designed as an incentive to avoid inefficient investment in dedicated pipelines where the associated flow would bypass the NTS. Upon requesting the OCC an entry/exit site specific rate is calculated by NGG providing an alternative charge to NTS entry/exit TO and SO commodity charges. Over time the calculation parameters have not been updated and the shorthaul tariff is increasingly attractive, even for relatively long distances. NGC are proposing an update to the calculation parameters and also to include a hard limit to the availability of the tariff to 60km (as the crow flies). Although the NGC proposal does not include a short haul arrangement once the enduring regime is in place, it is understood that there will be future modifications raised, as well as the existing 0621C proposal.

Revenue Recovery Mechanisms – In the event of a shortfall from capacity charges, NGG currently recovers the residual allowed revenue mainly through commodity charges, (with the exception of storage facilities which are exempt from commodity charges). However, the TAR code specifically requires commodity charges to be removed from Interconnector points from 2019. During the transition phase (2019-2021) there is likely to be a substantial shortfall from capacity charges. It is proposed that these are recovered by a commodity charge for non-IP point and through an uplift to the capacity charge at IP points (with the possible exception of historical contracts at IP points – see above). After 2021, revenue recovery will be entirely through a capacity based uplift.

Consistency with UNC Code Objectives

Both the code modification and the alternates must be evaluated against the specific Code Objectives and Charging Methodology Objectives set out in the NGC gas transmission licence. These can be summarised as follows.

Table 1: Summary of Code and Charging Objectives

Primary objectives	promote efficiency
	avoid undue preference
	promote competition
	Compliance with EU Regulation
	Encourage availability of gas to meet demand
Secondary objectives (on the basis that a) and b) of the charging objectives are subordinate to aa)[2]	reflect the costs incurred by the licensee in its transportation business;
	takes account of developments in the transportation business

Each proposal for code modification must be assessed against these objectives as part of the modification process. As a further iteration of the code objectives, the NTSCMF has additionally agreed (September 2016) specific objectives for the charging review based on the legal requirements discussed above. The main additions to the framework are around predictability and stability of charges with the underlying presumption that this is likely to encourage competition.

[2] For upstream businesses, the most relevant aspects of the code objective are those set out in point aa) since the tariffs produced by the new methodology will form the reserve prices for entry capacity auctions [check].

Issue	What does this mean to people?
Minimise Volatility	Minimise magnitude of changes within year; sensitivity of inputs in the overall reference price methodology and overall framework (inclusive of all adjustments, alternative products)
Predictability	Use of charges in their own charging frameworks, timing of changes and transparency . Including ability to understand methodology and reproduce/ forecast charges
Stability of prices	Minimise magnitude of changes year to year, sensitivity of inputs in the overall framework
Fairness	Equitable treatment for users where appropriate; how the design and application of discounts, exemptions and alternative products is done
Security	Promote competition, facilitate cross border trade and supply of gas from domestic and non-domestic sources. Charges should facilitate delivery of new and flexible supplies as well as demand side response.
Network efficiency	Charges should encourage efficient use and operation of the system. In a future of falling demand, changing supply patterns and probable decommissioning of system points the charging framework should facilitate optimal utilisation of the network including delivery of new investment and signalling of redundancy

The UNC Code Panel will take a decision, if necessary using a vote, on the Modification that both represents an improvement on the current charging system and that **best** reflects the Code Objectives as set out in the NGC license. The proposed modification is then submitted to Ofgem which can either approve or reject the proposal.

Ofgem Statutory Duties and Impact Assessment

In deciding whether a code modification can be approved Ofgem must demonstrate that it is consistent with its owns Statutory Duties set out in primary legislation. It is also required to carry out a wider impact assessment. Ofgem's Statutory Duties include many aspects that are similar to the code objectives discussed above. However, the main difference is that all these factors have to be assessed under the overarching primary objective in terms of the protection of consumers. It can be expected, therefore, that Ofgem will use the output of the Code workgroup in compiling its decision but it may also overlay its own analysis.

At the same time, given that the charging methodology is largely about allocation of a fixed amount of revenue that has already been determined, it could be argued that a charging regime that incentivises efficient use of the system, promotes availability and diversity of gas supplies, and promotes competition, all part of the code objectives, would be very likely to be in the interests of consumers as well. One question may be the extent to which Ofgem may seek to provide any quantitative evidence (i.e. modelling) to supplement the output of the workgroup which is likely to be largely a qualitative analysis. To some extent this could depend on the degree of consensus in the group.

Key Issues for Oil and Gas UK members

Every company will have its own strategy with respect to the entry points it uses, how it has booked capacity historically and how it intends to use the network in future. To a large degree the effect of the new charging regime will be distributional between upstream businesses rather than having a positive or negative impact on the upstream sector as a whole. This is because the 50-50 split of revenue recovery between entry and exit points will be retained.

a. Application of CWD and strength of locational signals

The rationale for the main features of the central 0621 modification, both in its own right and as the basis for other modifications is understood in terms of moving away from the largely obsolete LRMC methodology and to comply with the TAR Network Code in terms of adopting a capacity basis for the charging structure. In this respect 0621 represents a positive improvement over the design of the existing basic tariff methodology.

However, under the current charging regime, many participants have, over time, increasingly taken advantage of the possibility to book interruptible capacity at zero capacity charge. This has led to the bulk of transmission revenue being collected via a postalised commodity charge. Although this situation may not be sustainable given the requirements of TAR, our view is that retaining the de-facto postalised nature of the charging system as has many positive features in terms of competition and security of supply.

A key justification for moving away from LRMC based charging is the increasing irrelevance of capacity constraints in the transmission system. Another important feature of the market from a consumers' perspective, is the nature of the integrated national network required to deliver security of supply in more extreme conditions as evidenced by the experiences during winter 2017-18. National Grid's own data also underlines the there is no longer a prevailing flow of gas in the network.

Maintaining some form of locational signal, even in the absence of significant congestion, could be appropriate to the extent that it was thought that:

a. congestion or other costs such as maintenance can be avoided in future; and
b. businesses are able to respond to a stable methodology in deciding which entry and exit points to use.

On both these issues, the case for allocating costs on a distance basis and the relevance and effectiveness of the locational signals provided is questionable, particularly for entry points, and inconsistent with other government objectives such as MERUK. Higher charges at UKCS entry points will make MERUK more difficult to deliver. Likewise, the proposed methodology does not support competition since access to the "virtual balancing point" is at different cost depending on where gas is injected. Finally, this is not in the interests of consumers since it disadvantages particular sources of gas which, eventually, may result in a less diverse sources of supply.

Likewise, shippers using peripheral entry points such as St Fergus are unlikely to be able to easily shift production which will be based on long term investment in UKCS. Higher charges at such points are also not likely to help with the government's MER UK objective.

Finally, Oil and Gas UK also expects there will remain the need for a comprehensive UK wide transmission grid at the same scale as the existing network. Gas will continue to form a significant part of the energy mix until at least 2040. Thereafter, the maintenance of the network would also provide for options in decarbonisation of domestic and industrial heat through the use of hydrogen or biogas.

Oil and Gas UK favours those alternates that reduce the scope of locational signals with many members preferring postalisation of entry charges.

b. Treatment of historical bookings

Many network users have entered into longer term bookings as part of their commercial strategies and in line with the regulatory regime. These arrangements generally include a fixed capacity price over a multi-

year period with users also paying the commodity charge. It is notable that the commodity charge has increased significantly in recent years which those with historical bookings may or may not have been anticipating when booking capacity.

Article 35 of the TAR Code notes that "*the Regulation shall not affect the levels of transmission tariffs resulting from contracts or capacity bookings concluded before 6 April 2017 where such contracts or capacity bookings foresee no change in the levels of the capacity- and/or commodity-based transmission tariffs except for indexation, if any*". This suggests that network users with historical bookings should not be subject to any form of top-up on the capacity prices. However, Article 4 of TAR code only permits a commodity element to the charge at non-interconnector points. So, if commodity charges are removed at both IP and other entry points as in the NGC enduring approach, this would mean users with historical bookings would only pay the agreed capacity charge and make no further contribution to revenue recovery.

Although some may describe this as potentially distortive it should be noted that such a commitment made is a very different commercial arrangement to a shorter-term booking of less than one year. Previously such bookings have been used to facilitate investment and to reduce uncertainty for NGC (and thereby reducing NGC cost of capital). Likewise, those entering into such a contract have a legitimate expectation that their commitment will be recognised and with a recognition that the associated commodity charge could both increase and decrease.

Oil and Gas UK supports the principle of protecting the capacity charge element of historical bookings as required by Article 35 of the TAR network code. Some members consider that the revenue recovery element to be collected from these historical bookings should be reduced or removed.

c. Recovery of residual through commodity or capacity charge

The proposed removal of the commodity-based charge stems from the requirement that such charges are not applied at IP points, as well as the desire to avoid a difference in the charging regime for IP points compared to other entry points. Given that commodity charges would have the most direct impact on variable costs in landing gas in the UK, the minimisation of a potential distortion would appear to reflect the objectives.

Oil and Gas UK accepts that the central requirement of the TAR Code to move to a capacity-based methodology for charging. Provided that a suitable range of long and short-term capacity products are made available, including daily capacity.

The argument against such an assessment are two-fold. Firstly, it may be argued that commodity based charges can be more easily recovered through the wholesale price of gas although this depends on which is the marginal source of gas and this will vary depending on the time of year. Secondly it is argued that, if the capacity charge is allocated by shippers on the basis of volume, this will increase the variability of the cost expressed in p/KWh terms.

These arguments, however, to some extent assume that shippers will systematically book a higher amount of capacity than actual flows (e.g. based on an annual booking covering the maximum expected daily flow rate) rather than tailoring bookings to expected daily flows. To the extent that businesses are able to predict, and control daily entry flows they can avoid this issue and this means they will be largely indifferent between capacity and commodity based charges. On the other hand, this is less likely for exit capacity which will reflect consumer demand which is less easy to control or predict.

From a producer perspective there is a certain amount of indifference within Oil and Gas UK between commodity and capacity charges particularly if producers are not directly exposed to variations in demand. Capacity charges can be controlled to some degree by more active booking strategies. In any

case it should be expected that charges will be based on more accurate forecasts of capacity bookings which will minimise the residual element.

d. Discounts for storage and interconnectors

The TAR network code already requires a 50% discount to be given at charging points relating to storage facilities. The rationale for this is that without the discount users will potentially be obliged to pay for exit and entry at the site of the storage facility and that this is not cost reflective. Further analysis of the charges being paid by users of storage, particularly in the UK context have been made to justify a larger discount of 86% as reflected in a number of the alternates.

It is suggested further extending the discount such that users of storage facilities on the continent would also benefit from a discount to the extent that shippers were exporting gas in the summer and importing back to the UK in winter. To some extent both the proposed discounts have extending the logic from merely cost-reflectivity to a wider benefit that storage or access to continental storage is thought to bring to the availability of gas for consumers.

The case for such a direction of travel is not sufficiently demonstrated. It is not necessarily the case that particular network users offer more or less flexibility or benefits to security of supply. From recent events, it is clear that gas from a variety of sources are required to best meet demand rather than favouring or relying on a particular source. Likewise, there is no guarantee that gas placed into storage, either in the UK or on the continent, will necessarily be destined for UK consumers.

Likewise, it is also not obvious that a discount is the best method to manage transmission costs for users of storage. Once capacity charges are prevalent then storage users will be able, as others, to tailor their capacity bookings to reflect expected flows. Management of capacity positions and flows with the price at which gas is offered to the market are a core part of shippers' operations and the extension of the proposed discounts will potentially distort this process and provide an advantage to particular classes of network user at the expense of others.

Oil and Gas UK would generally not favour modifications or alternates that go beyond the minimum discounts required by the TAR code unless a clear case can be made on a cost-reflectivity basis.

e. Optional short haul tariff

The optional short haul tariff is designed to avoid a situation where network users have the incentive to by-pass the transmission system by building a separate connection to the entry point. This could potentially lead to the undermining the integrity of the network and the NBP as a liquid wholesale market.

Although the proposals in the NGC modification are sensible in terms of allowing for automatic uprating of the underlying assumptions and a distance cap, short haul should certainly be retained, and Oil and Gas UK would also support a modification that offsets the impact e.g. application to the capacity element or include the system operator charge.

Oil and Gas UK supports the continued use of a short haul element to tariffs

Oil and Gas UK
June 2018

ANNEX: ASSESSMENT AGAINST RELEVANT OBJECTIVES

Standard Relevant Objective:	0621 **a)** Positive **c)** None **d)** Negative **g)** Positive 0621A **a)** Positive **c)** None **d)** Negative **g)** Positive 0621B **a)** Positive **c)** None **d)** Positive **g)** None 0621C **a)** Positive **c)** None **d)** Negative **g)** Positive 0621D **a)** Positive **c)** None **d)** Positive **g)** Positive 0621E **a)** Positive **c)** None **d)** Negative **g)** Positive 0621F **a)** Positive **c)** None **d)** Negative **g)** None 0621H **a)** Positive **c)** None **d)** Negative **g)** Positive 0621J **a)** Positive **c)** None **d)** Positive **g)** Positive 0621K **a)** Positive **c)** None **d)** Negative **g)** Negative 0621L **a)** Positive **c)** None **d)** Negative **g)** Positive

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

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