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:	Charles Ruffell
Organisation:	RWE Supply & Trading GmbH
Date of Representation:	14th June, 2018
Support or oppose implementation?	0621 - Oppose 0621A - Oppose 0621B - Oppose 0621C - Oppose 0621D - Oppose 0621E - Oppose 0621F - Oppose 0621H - Oppose 0621J - Support 0621K - Oppose 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?* 0621J

Standard Relevant Objective:	0621 **a)** None **c)** Negative **d)** Negative **g)** Positive 0621A **a)** None **c)** Negative **d)** Negative **g)** Positive 0621B **a)** None **c)** Negative **d)** Negative **g)** Positive

	0621C **a)** None **c)** Negative **d)** Negative **g)** Positive 0621D **a)** None **c)** Negative **d)** Negative **g)** Positive 0621E **a)** None **c)** Negative **d)** Negative **g)** Positive 0621F **a)** None **c)** Negative **d)** Negative **g)** Positive 0621H **a)** None **c)** Negative **d)** Negative **g)** Positive 0621J **a)** None **c)** Positive **d)** Positive **g)** Positive 0621K **a)** None **c)** Negative **d)** Negative **g)** Positive 0621L **a)** None **c)** Negative **d)** Negative **g)** Negative

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)** Negative **aa)** Negative **b)** Positive **c)** Negative **e)** Positive 0621C **a)** Negative **aa)** Negative **b)** Positive **c)** Negative **e)** Positive 0621D **a)** Negative **aa)** Negative **b)** Positive **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)** Positive 0621H **a)** Negative **aa)** Negative **b)** Positive **c)** Negative **e)** Positive (continued overleaf)

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

	aa) Negative **b)** Positive **c)** Negative **e)** Negative

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

0621J

Modification proposal 0621J has been raised to address the serious defects associated with the CWD approach towards the allocation and recovery of NTS costs.

Under an efficient network charging regime, cost reflective capacity prices should be derived from the forward-looking costs of providing marginal increments of capacity at different network locations. These provide signals to users that encourage efficient network investment. The expected future scenario of enduring spare capacity on the NTS indicates that the marginal incremental costs to input or offtake gas will be low or close to zero.

Neither the CWD methodology nor the Postage Stamp methodologies are cost reflective (Charging Methodology Relevant Objective (a)) since the tariffs derived from these models do not reflect the underlying marginal investment cost drivers. However, both methodologies are designed to allocate and recover National Grid's historical (sunk) costs from users at entry and exit points in different ways.

The CWD methodology allocates costs based on notional point to point flows between all entry and all exit points that do not reflect actual usage of the system, illustrated by the Heat Map included in the Additional Analysis section at the end of this Representation. Consequently, it misallocates costs and results in unjustified discriminatory treatment of entry and exit points. The EU Tariff Code describes the CWD methodology but does not require it to be implemented. However, the CWD can serve as a counterfactual for the actual methodology used to allocate costs.

The Postage Stamp methodology under 0621J is designed to ensure recovery of the allowed revenue in an approach that is fair, proportionate, non-discriminatory and non-distortive. Setting tariffs uniformly on the basis of the network capacity at each entry and exit point ensures the efficient recovery of costs from all users (see Table 1 Additional Analysis section at the end of this Representation).

The Postage Stamp Methodology will promote effective competition (Standard Relevant Objective (d) and Charging Methodology Relevant Objectives (aa) and (c)) by:

- Facilitating efficient use of the NTS by competing gas supply sources, thereby ensuring NBP liquidity and security of supply;
- Supporting effective competition between suppliers and shippers in the gas market by allocating costs to users on the basis of non-discriminatory charges and ensuring that shippers pay same price for the same service across entry and exit;
- Minimising geographical distortions and ensuring that competition is driven by an effective cost recovery mechanism; and

- Ensuring that there are no unjustified distortions of the wider energy or electricity capacity markets.

0621/0621A/0621B/0621C/0621D/0621E/0621F/0621H/0621K/0621L

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Neither the CWD methodology nor the Postage Stamp methodologies are cost reflective (Charging Methodology Relevant Objective (a)) since the tariffs derived from these models do not reflect the underlying marginal investment cost drivers. However, both methodologies are designed to allocate and recover National Grid's historical (sunk) costs from users at entry and exit points in different ways.

Analysis in the Workgroup Report shows CWD locational charges create significant locational distortions, resulting in similar offtake points in terms of type, offtake volumes and distances from entry points facing materially different costs which have not been objectively justified. The CWD methodology misallocates costs relative to capacity (see Table 1 Additional Analysis section at the end of this Representation) resulting in inefficient under and over recovery of network costs from entry and exit. These misallocations are material.

The CWD methodology will have impact negatively on effective competition (Standard Relevant Objective (d) and Charging Methodology Relevant Objectives (aa) and (c)). In particular it will:

- Distort the wider energy and electricity capacity markets by misallocating costs to users;
- Result in inefficient entry and exit decisions by users of the gas transmission network, including creating the risk of stranded assets;
- Encourage inefficient investment in the gas transmission network with consequent costs for users.

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

The latest implementation date that is compliant with the EU Tariff Code is 31st May, 2019, with the methodology change taking effect for prices from 1st October 2019. Given the materiality of these proposals our strong preference is for an earlier implementation date to allow National Grid to provide a notice period consistent with those provided for other transportation rate changes, i.e. 150 days' notice for indicative charges and 2 months' notice for the final charges to apply. An early "minded-to" decision in Ofgem's Regulatory Impact Assessment, expected in late Q3 2018, will also be helpful.

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

We cannot make an informed assessment at this stage.

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.*

Yes.

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?*

We agree with the list of issues highlighted for consideration in the **UNC Workgroup Report - Part I**. In addition, the RIA should:

- Review DN Charging arrangements to ensure that they are compatible with capacity-based charging from 2021 and in particular the revenue adjustment mechanisms for pass-through of NTS Exit costs;

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)?*

   The introduction of a new Reference Price Methodology and reduction and removal of discounts for short-term and interruptible/off-peak capacity will lead to changes in capacity booking behaviour. An interim period is required to allow National Grid to understand and forecast the new booking patterns on a point by point basis as required for CWD. Variations between individual entry and exit point forecasts will introduce volatility and instability in prices.

   The Postage Stamp methodology uses aggregate entry and exit capacity to derive prices, so is not dependant on a point by point forecast. This will lead to more stable and predictable prices as the level of capacity, in aggregate, is less volatile.

   To avoid two structural changes, Postage Stamp with capacity rather than commodity for revenue recovery could be implemented from October 2019. Obligated Capacity could be used as the FCC as it is an open, transparent and predictable number that will aid the continued reproducibility of tariffs. Obligated Capacity could be replaced in the future by aggregate capacity values that more accurately reflected bookings. This approach would, arguably, have a less disruptive impact on prices.

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?*

   There will be uncertainty in the QSEC and relevant AMSEC auctions in 2019 as the charging framework prevailing at the time of bidding for capacity in the auctions will be different from that at the time that capacity is allocated.

   Shippers will require certainty ahead of the auctions about whether any capacity acquired will be considered as an interim contract and whether the payable price is fixed or floating.

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. The EU Tariff Code sets out a number of stages in the choice of Reference Price Methodology, the calculation of Reference Prices and the derivation of Reserve Prices. Some of the stages are prescribed as EU Tariff Code requirements, whereas others allow

for optional approaches. The proposed methodologies follow the prescribed elements in the EU Tariff Code while the optional elements have been interpreted to reflect GB circumstances.

An exception to this is 0621L, where we believe that including Existing Contracts for the calculation of entry capacity reference prices is not compliant.

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?*

We do not consider any of the proposed Reference Price Methodologies to be cost reflective as, by design, both methodologies are designed to allocate and recover National Grid's historical (sunk) costs from users at entry and exit points. However, the Postage Stamp methodology:

(a) enables network users to reproduce the calculation of reference prices and their accurate forecast;

The inputs (Allowed Revenue and aggregate entry and exit capacity) required by the Postage Stamp calculation are published and relatively stable.

(b) takes into account the actual costs incurred for the provision of transmission services considering the level of complexity of the transmission network;

Postage Stamp methodology is designed to allocate and recover National Grid's allowed revenue each year which includes historical (sunk) costs.

(c) ensures non-discrimination and prevents undue cross-subsidisation including by taking into account the cost allocation assessments set out in Article 5;

The preliminary ACER consultation and analysis undertaken by National Grid indicates that the capacity cost comparison index for Postage Stamp capacity prices are below the 10% threshold.

(d) ensures that significant volume risk related particularly to transports across an entry-exit system is not assigned to final customers within that entry-exit system; and

(e) ensures that the resulting Reference Prices do not distort cross-border trade.

As Postage Stamp capacity charges are uniform across all locations, this removes distortions.

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 specific capacity discount (86%) for storage in 0621J (and other Alternatives) reflects the EU Tariff Code obligation for a minimum of 50% discount to avoid double counting charges together with the additional, wider support and flexibility services it delivers to both the NTS and gas shippers and gas suppliers.

We do not think that sufficient evidence has been presented to support the proposal that bi-lateral Interconnection Points directly compete with storage as providers of flexibility and therefore warrant a similar specific capacity discount.

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.*

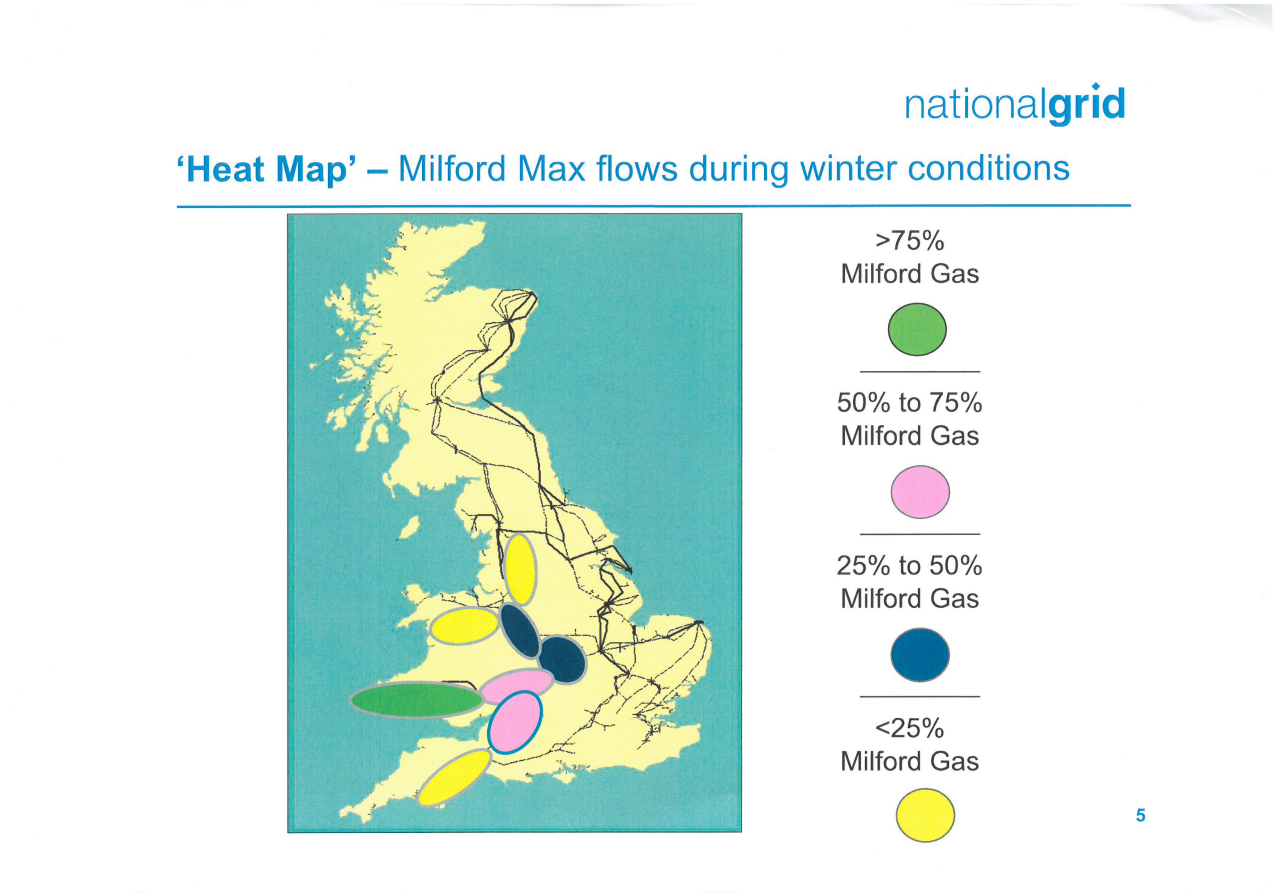
National Grid has provided models to calculate tariffs under each of the options, together with a recently updated document "Summary of comparisons between the UNC0621 modifications on key areas and potential outcomes of the proposals". The way the methodologies allocate costs creates distributional effects under all options, but we believe that these are minimised and less-

distortive by allocating costs on the basis of capacity only under the Postage Stamp methodology rather than CWD.

It would be informative to extend Table 1, below, to include the Revenue Allocation by sector under LRMC compared to capacity share. This needs to be on the basis of actual recovery, by sector rather than modelled as it would be useful to understand the different sectors' contribution to cost recovery relative to their capacity share and the extent to which this is impacted by any change in charging methodology.

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

0621J



This was presented as part of the analysis for 0645S: Amending the oxygen content limit in the Network Entry Agreement at South Hook LNG and shows penetration of Milford Haven gas at peak conditions. It is unclear whether the proposed CWD reference price methodology is consistent with the EU Tariff Code Article 8 in relation to Relevant Flow Scenario.

Table 1: Comparison between Exit Capacity Share and Revenue Allocation, by Sector, under Postage Stamp methodology and CWD

	Exit Capacity Share	Revenue Allocation using Postage Stamp methodology	Difference between Capacity Share and Revenue Allocation	Exit Capacity Share	Revenue Allocation using CWD methodology	Difference between Capacity Share and Revenue Allocation
GDN (EA)	5.9%	6.0%	0.2%	5.9%	5.9%	0.0%
GDN (EM)	7.2%	7.4%	0.2%	7.2%	6.0%	-1.2%
GDN (NE)	5.2%	5.4%	0.2%	5.2%	3.7%	-1.5%
GDN (NO)	4.5%	4.7%	0.1%	4.5%	3.6%	-0.9%
GDN (NT)	7.5%	7.8%	0.2%	7.5%	8.0%	0.4%
GDN (NW)	8.7%	9.0%	0.3%	8.7%	8.5%	-0.2%
GDN (SC)	6.8%	7.0%	0.2%	6.8%	6.6%	-0.1%
GDN (SE)	10.0%	10.3%	0.3%	10.0%	12.2%	2.2%
GDN (SO)	6.4%	6.6%	0.2%	6.4%	7.8%	1.4%
GDN (SW)	4.6%	4.7%	0.1%	4.6%	6.1%	1.5%
GDN (WM)	6.2%	6.4%	0.2%	6.2%	5.9%	-0.3%
GDN (WN)	0.9%	0.9%	0.0%	0.9%	0.9%	0.0%
GDN (WS)	3.9%	4.0%	0.1%	3.9%	5.0%	1.1%
POWER STATION	11.4%	11.2%	-0.1%	11.4%	11.8%	0.4%
STORAGE SITE	2.6%	0.4%	-2.2%	2.6%	1.1%	-1.5%
INTERCONNECTOR	6.3%	6.2%	-0.1%	6.3%	5.4%	-0.9%
INDUSTRIAL	2.1%	2.1%	0.0%	2.1%	1.6%	-0.4%
	100.0%	100.0%		100.0%	100.0%	

Table 1 considers the Enduring period and compares the share of exit capacity by sector as used in the models (User Input Capacity Levels (kWh/day) with the share of revenue allocated by the different charging methodologies based on these capacity levels.

Under Postage Stamp, intuitively, the capacity shares and revenue shares are extremely close. Under CWD there are a number of sectors where the methodology misallocates costs relative to capacity, ranging from an over-allocation of 2.2% to an under-allocation of -1.5%. Under both methodologies, the variances associated with storage reflect the capacity discounts applied.

Changes in the charging methodology will inevitably result in a redistribution of allowed revenue recovery between the sectors. The Postage Stamp methodology minimises any adverse consequences over and above those arising from redistribution, by setting charges uniformly on the basis of the network capacity at each entry and exit point.

NTS Optional Commodity Charge

We fully support the principle underpinning the current NTS Optional Commodity Charge (shorthaul) that promotes greater utilisation of the NTS by avoiding inefficient by-pass and proliferation of pipelines. With the expected removal of commodity charges for revenue recovery from October 2021, a replacement for the current formula is needed. The methodology underlying the charge should lead to substantively similar charges for similar size offtakes shorthauling over similar distances from different entry points. It should be self-limiting and based around the avoided costs of building and operating a dedicated pipeline rather than to compensate for locational distortions created under CWD.