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:	Gerry Hoggan
Organisation:	ScottishPower Energy Management Ltd
Date of Representation:	22 June 2018
Support or oppose implementation?	0621 - Comments 0621A - Comments 0621B – Qualified Support 0621C - Comments 0621D - Oppose 0621E - Comments 0621F - Oppose 0621H - Comments 0621J - Comments 0621K - Comments 0621L - Comments
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 Relevant Objective:	0621 a) Negative c) Negative d) Negative g) Positive 0621A a) Negative c) Negative d) Negative g) Positive 0621B a) Positive c) None d) None g) Positive 0621C a) Positive c) Negative d) Negative g) Positive 0621D a) Negative c) Negative d) Negative g) Positive 0621E a) Negative c) Negative d) Negative g) Positive 0621F a) Negative c) Negative d) Negative g) Positive 0621H a) Negative c) Negative d) Negative g) Positive 0621J a) Negative c) Negative d) Negative g) Positive 0621K a) Negative c) Negative d) Negative g) Positive 0621L a) Negative c) Positive 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)** Negative **aa)** None **b)** Positive **c)** None **e)** Positive 0621C **a)** Negative **aa)** Negative **b)** Positive **c)** Positive **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

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

0621B

If any of these modifications is to be implemented then MOD0621B would be the preferred option for the following particular reasons: -

- The use of a uniform unit commodity based revenue recovery charges will direct revenue recovery costs to those parties who utilise the system, without any locational element or distortional effect on competition. We are comfortable that the use of such a commodity based revenue recovery charge is compliant with TAR.
- The use of obligated capacity as a proxy for Forecasted Contracted Capacity ("FCC" and which in itself is an undefined term) on an enduring basis will ensure an element of certainty into the calculation of the relevant reference price. It will avoid issues around the future development of a sufficiently robust methodology to calculate the FCC based on forecast values and the potential implications of material errors in any such forecast and how they would be reconciled or addressed
- Commoditised revenue recovery charges will provide greater alignment with the operational requirements of gas fired generation in its role as support for intermittent renewable generation
- The proposal more accurately reflects the full value of storage by providing for a 86% capacity charge discount
- The proposed enduring NTS Optional Charge will be critical in mitigating some of the perverse effects of the CWD methodology, whereby some exit points located close to entry points nonetheless pay disproportionately high capacity charges.

0621

Particular elements of the proposal are incomplete such as the methodology to develop an enduring FCC and optional charge. Whilst we understand the reasons why it has not been possible to develop these methodologies at this stage it is difficult to be supportive in their absence on the assumption that sufficiently robust arrangements will eventually developed and implemented. Furthermore in the event that a sufficiently robust methodology was to be developed, this would of itself result in an even higher proportion of revenue being recovered via capacity charges which we consider would lead to further and greater distortions.

We do not consider that the level of discount for storage is adequate or has been fully justified. Rather it appears to be simply the application of the minimum 50% required by the regulation without further analysis or justification.

Furthermore the application of an arbitrary distance cap may be pragmatic and produce what may be perceived as acceptable outcomes, although it is difficult to justify objectively.

The remainder of the Alternatives are substantially based on MOD0621 but modified to take account of particular elements of the charging regime which the proposers consider to have been inadequately addressed in the principal modification

0621A

Whilst we support the 86% specific capacity discount proposed for storage as being more reflective of the tree value of storage other essential elements of the overall package we consider are lacking as in 0621 such as robust enduring optional charge and FCC Methodologies.

0621C

We recognise the merit and support the application of commodity based revenue recovery charges and the balance that that strikes with regard to charges paid by historical contracts.

We agree with the proposed application of an 86% capacity discount for storage and also the proposed application of an enduring optional charge.

0621D

We do not support this proposal as it does not allow for an appropriate equivalent to the current Optional Commodity Charge and therefore there will be no mitigation of some of the perverse results of application of the CWD model for those exit points located close to entry points.

Furthermore, although the impact of the CWD may be moderated by the use of the square root of distance, this appears arbitrary and without objective justification.

0621E

The extended transitional period envisaged by this proposal would provide a further period for National Grid to assess behavioural changes and would align implementation more closely with the Electricity Capacity Market Auction timelines.

The retention of commodity based revenue recovery charges for non-IPs would be beneficial and to an extent would address some of the issues regarding historical capacity contracts by retaining the contractual charging structure.

0621F

We do not consider that the case has been made for bi-directional interconnectors to be treated comparably to storage facilities and nor has there been adequate justification for the level of discount sought.

0621H

We recognise the arguments around contractual sanctity and the reasonable expectation of parties to long-term contracts. However simply to look to exempt such parties from all future revenue recovery charges would go beyond maintaining the current status quo. Rather it would place them in a more advantageous position than currently where commodity based recovery charges are payable in terms of such contracts.

0621J

We recognise that the postage stamp methodology results in a reasonable and predictable allocation of costs, albeit perhaps not particularly cost reflective, where, as in this case, the system is unconstrained and locational signals are less appropriate

0621K

Albeit the 86% capacity discount entitlement does more fully reflect the full value of storage the 100% off-peak/interruptible capacity discount for storage sites has not been fully justified. Nor does the proposal adequately make the case for the application of that discount exclusively at storage points

0621L

Whilst we see merit in the argument around the treatment of existing contracts we do not consider the proposed 50% discount for storage does not adequately reflect the value of storage and for that reason cannot support 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.*

Implementation will be driven by the need to comply with the EU Tariff Code and as a consequence must be by 31st May 2019. The charges determined in accordance with whichever new methodology is approved will thereafter be effective from 1st October 2019. It will be critical that parties are given as much advance notice as is possible allowing for the potential scale and structural nature of the changes involved. As a minimum the existing notice periods as per National Grid’s Licence in respect of both indicative and final charges should be applied. This would allow parties a greater opportunity to take due account of such charges in their commercial strategies/arrangements.

Additionally, allowing for the scale of changes involved and the re-structuring of the nature of the charges a minded-to decision from Ofgem as part of its Impact Assessment would be beneficial or at least a short-listing of the options under consideration. This would at least start to narrow the range of likely outcomes arising from the principal proposal and the ten alternatives under consideration and allow parties a better opportunity to assess and plan accordingly.

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

Whilst we have identified that the impacts will most likely be significant and distributional we are not yet in a position to make an informed, detailed assessment at this stage, allowing for the status of the analysis carried out to-date (see below) and the range of Alternatives under consideration.

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 are reasonably comfortable that the respective legal texts should deliver the intent of each solution we have not had these legally reviewed.

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?*

Workgroup participants deliberated at length on what issues they considered should be addressed as part of Ofgem Regulatory Impact Assessment, particularly those that fell outwith the remit of the Workgroup but were identified as potentially being of wider significance.

Section 10 of the Draft Workgroup Report provides a comprehensive list of those issues. We agree that each of those issues should be examined in terms of the RIA and with particular regard to both security of supply and end consumer costs. Furthermore, we believe that particular consideration should be given to the potential impacts on storage viability, as highlighted in the paper submitted by Storengy on 17 April 2018 during the development of the Workgroup Report.

We would also reference the report commissioned from Frontier Economics by Energy UK and its findings in key wider areas of concern, in some areas beyond the scope of the UNC Modification Process, namely – cost reflectivity, competition, security of supply, cost recovery, effect on end consumers and compliance. The report is available via this link (Frontier Economics Report 11 June 2018) and we would urge Ofgem to consider that analysis and evidence and give them due weight within the Regulatory Impact Assessment.

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)?*

There are a number of aspects to the rationale behind having a transition period.

Initially it would allow National Grid to assess possible changes in capacity booking behaviour that may come about as a result of the structural change involved in moving from a lower capacity/higher commodity to a high capacity low capacity model and also the move away from discounted short term and interruptible capacity products.

Moreover National Grid would have the opportunity to develop and implement a methodology, which is otherwise not available at this time, to determine a robust and accurate Forecast Contracted Capacity (FCC) in the context of that amended booking behavior. That would replace the use of obligated capacity which will be utilised as a FCC proxy in the transitional period to provide a measure of price stability and predictability.

A transitional period would also allow due account to be taken of likely significant impacts that may arise from RIIO-2 on aspects that are critical to the calculation of charges such as allowed revenues and/or capacity baselines.

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?*

Shippers should be entitled to expect a measure of certainty regarding the status of the capacity that they are bidding for. This is particularly significant where the price of that capacity may have protected status for the life of the contract or whether that price would float and be subject to re-calculation year on year. The absence of such certainty would make longer term strategic planning problematical

An early decision from Ofgem ahead of the auction would be ideal but if the process timing does not lend itself to that then at least a minded to decision may help mitigate some of that uncertainty and give parties a clearer indication of the likely long term arrangements.

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?*

We are comfortable that all the proposals are broadly compliant with relevant EU regulation to the extent necessary – TAR is only applicable to IPs - although we have not subjected the various proposals to detailed legal scrutiny.

That having been said some provisions of TAR are drawn in such a way as to be capable of differing legal interpretations each of which may be credible and plausible. The initial legal view on compliance would rest with the Regulator although ultimately a definitive ruling on compliance may only be determined by the relevant court following due process.

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?*

In the absence of a robust definition of "cost reflective" it is difficult to undertake an appropriate comparison. However, it is recognised that some aspects of each of the above methodologies contain appropriate cost reflective elements to a greater or lesser extent.

Beyond that though it is also accepted that each of the proposed methodologies is largely designed to allocate and recover National Grid's Allowed Revenue on a basis that is more equitable and appropriate than the current LRMC basis (to the extent that National Grid's Allowed Revenue may be taken as reflective of historic and future costs of operating the network).

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 50% discount for storage is the minimum prescribed by TAR and is intended simply to avoid double counting. The analysis produced by Water Wye Associates (see link *WWA Report 21 November 2017)* and submitted as part of the Workgroup process included evidence of the wider embedded benefits that storage brings to both the system and shippers in the way of network support and access to flexible supplies. We endorse the conclusions drawn from that analysis and that the 86% discount proposed is of itself more “cost reflective” and thus promotes effective competition.

In contrast, interconnectors connect separate markets and so cannot provide the equivalent additional local network support that storage can offer. Rather interconnector flows will be determined by relative prices in the respective markets and the application of a discount to interconnectors may favour external markets over indigenous sources, thus creating a competitive distortion.

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.*

The draft Modification Report highlights that insufficient time was available to fully scrutinise or develop a number of aspects of the proposals.

We recognise and appreciate the significant work and commitment from National Grid in developing appropriate models and supporting analysis. However, perhaps it may have been more advantageous for the analysis to have been produced at an earlier stage in the process to help shape and develop the proposals and in turn provide supporting evidence for those proposals. Indeed, work on updating and correcting analysis has been ongoing during the consultation period with updated models and analysis being produced as late as 13th June 2018. This clearly adversely affects the ability to review and consider the impacts in a timely manner such that an extension to the consultation period, or supplementary consultation, would be appropriate.

Unfortunately the process has also resulted in an unprecedented number of Alternatives and what appears to be a range and diversity of proposals which in many respects appear more representative of particular perspectives on how the charging arrangements should be structured. This is perhaps not surprising where the issues being considered impact charging where commercial and vested interests are inevitably at play.

It may have been preferable had the process adopted led to a more clearly holistic, optimal solution in the best interests of the GB gas market, network users and end consumers, rather than a solution which appears to have been more focussed on cost allocation and recovery.

That allied to the time constraints resulting from the need to comply with TAR, in respect of those aspects of the proposals impacted by the regulation, has led to a compressed assessment and review period. This in turn has resulted in potentially inadequate analysis and consideration and understanding of the wider impacts arising from any restructuring of charges.