

**UNC 0670R Workgroup Minutes**  
**Review of the charging methodology to avoid the inefficient bypass**  
**of the NTS**

**Thursday 10 January 2019**

**Radcliffe House, Blenheim Court, Warwick Road, Solihull B91 2AA**

**Attendees**

Rebecca Hailes (Chair)	(RH)	Joint Office
Helen Cuin (Secretary)	(HCu)	Joint Office
Adam Bates	(AB)	South Hook Gas
Alex Nield	(AN)	Storengy UK
Alsarif Satti*	(AS)	Ofgem
Andrew Pearce	(AP)	BP
Anna Shrigley*	(AS)	ENI
Bill Reed	(BR)	RWE Supply & Trading
Chris Wright	(CW r)	Exxon Mobil
Christiane Sykes*	(CS)	Shell
Colin Williams	(CW i)	National Grid
Debra Hawkin	(DH)	TPA Solutions
Graham Jack	(GJa)	Centrica
Helen Bennett*	(HB)	Joint Office
Henk Kreuze	(HK)	Vermilion Energy
James Gudge	(JG)	National Grid
James Thompson*	(JT)	Ofgem
John Costa	(JCo)	EDF Energy
Julie Cox	(JCx)	Energy UK
Kamla Rhodes	(KR)	ConnocoPhillips
Kirsty Ingham	(KI)	ESB
Meha Shah	(MS)	Exxon Mobil
Niall Coyle*	(NC)	E.ON
Nick Wye	(NW)	Waters Wye
Nicky White	(NW h)	nPower
Nigel Sisman	(NS)	Sisman Energy Consultancy
Nitin Prajapati*	(NP)	Cadent
Pavanjit Dhesei*	(PD)	Interconnector UK
Penny Garner	(PG)	Joint Office
Penny Jackson*	(PJ)	nPower
Richard Fairholme	(RF)	Uniper
Sinead Obeng	(SO)	Gazprom Marketing and Trading
Smitha Coughlan*	(SCo)	Wales & West Utilities
Steve Pownall	(SP)	Xoserve
Terry Burke	(TB)	Equinor

\* via teleconference

Copies of all papers are available at: <http://www.gasgovernance.co.uk/0670/100119>

*The Request Workgroup Report is due to be presented at the UNC Modification Panel by 16 May 2019.*

## 1.0 Introduction and Status Review

### 1.1. Approval of Minutes (04 December 2018)

RH noted that a number of comments had been provided for the minutes on the 04 December and these had been published in a changed marked version at:

<http://www.gasgovernance.co.uk/0670/041218>. NS confirmed some clarity had been added around Shorthaul and an omission regarding European Codes.

The minutes with the requested amendments were approved.

### 1.2. Review of Outstanding Actions

**1201:** National Grid (JG) to review the objective statement “*Inefficient bypass can be defined in this context as any gas that could have used the NTS, distributing costs over a wider base*” to provide more clarity.

**Update:** JG confirmed that the slides had been reviewed since the last meeting along with the objectives and principles, and some minor amendments had been made. However, given Ofgem’s recent 0621 decision letter he suggested considering a different presentation as some of the comments would need refining in light of Ofgem’s comments, specifically on Shorthaul and how these can be factored in. **Closed.**

**1202:** National Grid (JG) to update the principles to clarify that an idea could be a capacity and commodity-based solution.

**Update:** As above. **Closed.**

## 2.0 Workgroup Discussion

JG provided a presentation highlighting the key elements of Ofgem’s decision letter relating to the NTS Optional Charge (NOC) for discussion and consideration against any future proposals.

JG confirmed that Ofgem considers that both the existing Optional Commodity Charge (OCC), and proposed NTS Optional Charge (NOC), result in a cross-subsidy between those who can, and those who cannot, utilise the charge.

In Ofgem's view there is insufficient evidence that parties would by-pass the NTS in the absence of the NOC and they consider that the NOC in the form proposed in the 0621 modifications would still have a negative impact on competition. In the event there is a genuine risk of construction or use of a competing pipeline that could increase the level of charges for remaining consumers, then the development of any charges to account for that would need to ensure that they comply with relevant legislation.

NW noted that the response from Ofgem indicates areas of non-compliance however the critique does not suggest what would be compliant and the applicability of other tests. JG suggested there is more support for the approach taken by Independent Pipelines (IPs), however it is difficult to see what an applicable test for a shorthaul charge would be. NW highlighted what is clear, is that the distance cap may not be appropriate.

JG believed there was an opportunity to discuss potential products, he confirmed he had been looking at changing the baseline methodology, he acknowledged there might be a compliance issue but questioned if this approach would better facilitate the relevant objectives than what is in place now.

NW noted that Ofgem’s response does say that the approach of IPs is not entirely compliant however it was compliant with certain elements of the Tariff Network Code (TAR NC), so it was difficult to glean if a capacity-based tariff would be compliant.

NS, referring to page 9 of Ofgem’s decision letter, commented that it was not apparent that such a discount would be compliant. While this may be better managed by a version of the NTS Optional Charge (NOC) proposed by 0621C (a capacity-based NOC, that is calculated as

a discount to the reference price), it is not apparent that such a discount could be reconciled with the Tariff Code.

NW and NS disagreed on whether the allowance would be permissible nor that there is no facility for discount either. DH wished to understand what this statement was trying to capture as it was not apparent that these types of discounts would be compliant with the TAR Code. JT confirmed that Ofgem had looked at the modification and found elements not compliant with the TAR Code, he clarified that Ofgem are not stating that there should not be a shorthaul charge, they were just highlighting that some elements are not compliant.

NW asked for better clarity regarding compliance with Article 4(3) capacity-based charges. He wished to understand if the Independent Pipeline (IP) approach was compliant or not. DH asked Ofgem if shorthaul is permissible under the TAR Code and under which Articles it would be.

SO highlighted that Ofgem can only provide a view on what is presented to them and if the industry made it clear that the shorthaul is not a standard product but is a conditional product, this would be considered. NS wanted to be clear that the current shorthaul products should not be considered as a conditional product, these are bulk standard with no restriction on the capacity.

NS noted that there is a strong view from the commission and ACER that the industry should be developing a non-discriminatory service that charges parties the same price. There is no justification for a two-tier product, moving away from zero based pricing and shorthaul.

GJ believed Ofgem were not pushing for shorthaul being out of bounds. NS suggested Ofgem have simply not seen anything that is compliant yet.

NW confirmed he had been looking at the law and considering if there is suitable flexibility that may fit and the law may allow a shorthaul product. NS noted however this would be very restrictive.

NW believed that Ofgem had suggested that the proposal from the IPs is compliant with the with Article 4(3), however it does not state if it is compliant with the rest of the TAR code. NW noted that it would have been particularly helpful if Ofgem had indicated what would be complaint.

CW acknowledged the concerns being raised and clarified that Ofgem's decision letter will feed into what gets developed next. He recognised the industry has a range of criteria to examine, there are additional tests, and that Article 4(2) needs to be considered.

JT confirmed in terms of IPs, Ofgem does have concerns with cross-subsidy. NW understood the product needed to *be* cost reflective and not *create* cross-subsidy.

NS noted the strong emphasis on discounts and significant restrictions, he suggested a general principle, that the only place for capacity discounts is for specifically designated points outlined in code.

JG suggested there could be an option for a discount with a multiplier of less than 1, taking reference prices from 0621C for specific daily products where there is a genuine risk of bypass. He suggested applying a multiplier less than 1 to a daily product over a longer period but not on an annual basis. The rules would apply on a uniform basis for this discount at the point, on the agreement no bypass would be built.

HK asked how this would work where there is only an exit point.

BR highlighted that power stations will look at the longer-term costs and whether it would be more cost effective to build their own pipeline rather than connecting to the NTS. At some locations it will be cost effective but it this is not the case in every situation.

DH explained that the current shorthaul tariff has no long-term commitment. BR suggested in practise the industry needs to come up with a solution that meets the drivers and meets the TAR Code. JG acknowledged the need to consider extracts from the decision letter and how to build a product that achieves compliance.

PD enquired how this would work at Bacton; he asked how it would make sense at Bacton, if there was a discount at the Bacton exit point, how would this work with the Prisma Auctions, with a daily product, where auction premiums kick in and parties are buying capacity.

The Workgroup considered a discount to the reference price tying back to the reference price methodology. DH enquired if this would apply to entry and exit. GJ explained if the conditions are met, the discount could be applied to entry and exit.

NW suggested the need to outline what concepts would be compliant.

From Page 4 of the presentation, JG summarised Articles 4(1), 4(2) and 4(3):

Article 4(1) of the TAR Code sets out the defining characteristics of a “transmission service”, Ofgem consider NOC is the provision of a transmission service.

Article 4(2) states that “Transmission tariffs may be set in a manner as to take into account the conditions for firm capacity products”. The term “firm capacity” is defined in Article 2(16) of Regulation (EC) No 715/2009 as “gas transmission capacity contractually guaranteed as uninterruptible by the transmission system operator”.

Article 4(3) of the TAR Code establishes the rule that the transmission services revenue shall be recovered via capacity-based transmission tariffs.

The Workgroup considered the definition of transmission services.

BR highlighted the need to incentivise parties not to build a bypass.

The Workgroup briefly considered if providing a discount challenged the classification of a transmission service, and if this service is not provided, the User may not stay connected. If the user stays connected, they are contributing.

JG believed that the solution would need to be a firm capacity product.

JG highlighted on Page 5 that as an exception to the rule, the transmission services revenue shall be recovered via capacity-based transmission tariffs, *commodity-based tariffs may be allowed, subject to the approval of Ofgem and the requirements set out in Article 4(3)(a) and 4(3)(b)*.

JG noted that one of the key aspects of rejecting the commodity-based service is that the TAR Code requires any exempt flow-based charge to be calculated on the basis of forecasted or historical flows, or both, and set in such a way that it is the same at all entry points and the same at all exit points.

BR stressed the importance of considering the Forecasted Contracted Capacity (FCC), if there is no capacity measure at the entry or the exit point FCC is zero.

JG also noted that for Article 4(3)b it was Ofgem’s view that a complementary recovery charge to manage revenue (under and over recovery) cannot be justified, as the NTS Optional Charge is based on the hypothetical cost of investment in a bypass pipeline. Hence it cannot be considered a tariff determined to meet an allowed revenue target.

From Page 7 JG highlighted that the NTS Optional Charge is intended to be broadly reflective of the estimated cost of laying and operating a dedicated pipeline to NTS specifications.

NS noted that that cross-subsidy and cost reflectivity had been a focus for Ofgem for many years. He believed there was a view from several parties that there is an unacceptable level of cross-subsidy caused by zero tariffs.

AS enquired about the relevance of cost reflectivity and optional commodity charges to offer a discount, if looking at a discount at the reference price, this would reflect charges differently, the fixed commodity charge in the current regime is inflating the commodity charge, it is creating problems with cost reflectivity, where there is a problem with disproportional costs of the network. It was questioned what proportion is collected from the optional commodity charge, and if the aggregated level is growing it would indicate the charge is not cost

reflective. If the optional charge can act as a discount it would be more cost reflective, if applied to the floating capacity charge.

The Workgroup considered the distance cap and if there is a rationale for it, it was believed that the distance cap is not completely out-ruled as a theory, it simply needs a better rationale. JG highlighted that with the issues around commodity-based tariffs identified, Ofgem would still have concerns regarding cost-reflectivity.

RF noted that the objective will be to avoid Users disappearing. He recognised that there is a need to look at and develop a product, that Ofgem would need to assess any cross-subsidy, if there is a genuine risk of bypass, and if there is due or undue cross-subsidy.

NW provided a presentation on Waters Wye's suggested approach outlining idea 3 - Cost Reflective Bypass Avoidance Charge. The Workgroup considered the approach. NW explained that this is based on a bottom up approach, applying a tariff to reflect the cost of building a pipeline, and is capacity based.

NW provided some assumptions, the methodology and 2 approaches, available to all Users except storage. The level of charge derived should provide enough incentive to avoid inefficient bypass.

- For Approach 1 – the concept is intended to replace the standard entry and capacity charges at applicable points
- For Approach 2 – the design is intended to recover the cost of building the pipeline, with the ability to recover cost with a top-up charge.

NW explained a reconciliation would need to be undertaken.

The Workgroup considered how the approaches would work and the proposed assessment criteria. The Workgroup considered if the product is looking at a cost reflective charge for utilising a part of the NTS, and that National Grid should recover the full allowance, therefore approach 2 might be more appropriate.

JG noted that the options are cost reflective to the User and but not based on the system, and whether there should be a charge element for access to the NTS. It was suggested that a distance calculation and a Capacity Weighted Distance (CWD) would need to be considered (a Z Factor), to reflect what the capacity charge would be with a ratio (less than 1 multiplier).

BR enquired about an annual bespoke discount, which considers the break-even point. If this was 1, a bespoke discount could be applied, ie. a Z Factor annual bespoke discount. If this was less than 1 a factor could be added back on (conceptionally).

AS asked the concept of opting for a charging methodology allocating revenue and if it is appropriate to have an optional commodity charge or having a cost reflective charge. He enquired about determining the cost reflectively of the system, and whether the CWD, postage stamp or square route allowed revenue, determined the cost reflectivity and then splitting it as best as possible.

The Workgroup considered the concepts of System costs (i.e. NTS Network costs) verses Users costs. NW suggested to make an informed choice the cost has got be the cost of building the pipeline to get to a cost reflective charge. However, JG enquired if the system costs should take into account the service the user is acquiring, and what the compliance solution is.

JG believed there are two concepts that need the details bottoming out, and to allow the Workgroup to look at the methods, the feasibility tests, and how to calculate the charges. NW was keen to accelerate the progression. BR encouraged the production of a strawman for each concept for the next meeting.

JG advised it was originally planned, as an adaptation of the NTS Bypass Avoidance Charge, to introduce a more direct link to pipeline costs. Therefore, he will be raising more high-level concepts for discussion, following the 0621 decision. The concepts were:

- Alternative or adjustment of capacity charges; and
- User commitment through the application process and non-use charges (only available where firm capacity booked).

He confirmed that feasibility testing needed to be included and the options to be discussed are distance cap based on generic cost calculations through to Permitting, Front End Engineering Design (FEED) and Final Investment Decision (FID).

The Workgroup considered the cost and benefits of building a separate pipeline and justification for providing shorthaul.

JG was happy to consider factoring in User commitments. He understood the process needed to be much more stringent than it currently is. BR suggested the Workgroup needs to consider the User's commitment to maintain connection to the NTS. If there is a User commitment, with a simple commitment test, the User commitment needs to be reasonable and may need to take into account commitments for 2, 3 or 4 years.

JG wanted a simple calculation and to consider Ofgem's concerns.

It was suggested that a good starting point should be a calculation based around pipeline costs, with some element of User commitment, and something that satisfies the points raised by Ofgem around the genuine concerns with inefficient bypass of the NTS.

GJ suggested the industry may also wish to consider, that making shorthaul very unattractive could have impacts on other gas markets, affecting liquidity, wholesale gas prices and detriments to the GB consumer, not just onshore pipelines.

RF noted that a User's commitment depends on the design, the year to year charging calculation fluctuation, the risk of movement, and the volatility, which may deter interest. Fewer fixed charges will be less attractive.

NW observed that if using a bottom up method, the amount payable could be fixed (excluding inflation).

It was agreed further consideration would be required at the next meeting.

### 3.0 Next Steps

The focus for the next meeting will be to further consider the presented concepts in more detail either as a strawman or as draft modifications.

### 4.0 Any Other Business

KI provided the following links to the Northern Irish decision by UREGNI from December:

<https://www.uregni.gov.uk/publications/decision-harmonised-transmission-tariffs-gas>

Responses to consultation: <https://www.uregni.gov.uk/publications/consultation-responses-harmonised-transmission-tariffs-gas>

ACER's comments. <https://www.acer.europa.eu/m/news/Pages/News-Details.aspx?ItemId=321>

### 5.0 Diary Planning

Further details of planned meetings are available at: <https://www.gasgovernance.co.uk/events-calendar/month>

Workgroup meetings will take place as follows:

Time / Date	Venue	Workgroup Programme
10:00 Tuesday 05 February 2019	Elexon, 350 Euston Road, London NW1 3AW	Consider 2 proposals provided including worked examples and both feasibility and commitment tests.

10:00 Tuesday 05 March 2019	Radcliffe House, Blenheim Court Warwick Road Solihull B91 2AA	
--------------------------------	---	--

**Action Table (as at 10 January 2019)**

<b>Action Ref</b>	<b>Meeting Date</b>	<b>Minute Ref</b>	<b>Action</b>	<b>Owner</b>	<b>Status Update</b>
<b>1201</b>	04/12/18	4.0	National Grid (JG) to review the objective statement "Inefficient bypass can be defined in this context as any gas that could have used the NTS, distributing costs over a wider base" to provide more clarity.	National Grid (JG)	<b>Closed</b>
<b>1202</b>	04/12/18	4.0	National Grid (JG) to update the principles to clarify that an idea could be a capacity and commodity-based solution.	National Grid (JG)	<b>Closed</b>