

**Representation - Draft Modification Report**

**UNC 0678; 0678A; 0678B; 0678C; 0678D; 0678E; 0678F; 0678G; 0678H; 0678I; 0678J;**

**Amendments to Gas Transmission Charging Regime**

0678	Amendments to Gas Transmission Charging Regime
0678A	Amendments to Gas Transmission Charging Regime (Postage Stamp)
0678B	Amendments to Gas Transmission Charging Regime
0678C	Amendments to Gas Transmission Charging Regime (Postage Stamp)
0678D	Amendments to Gas Transmission Charging Regime including a Cost based Optional Capacity Charge
0678E	Amendments to Gas Transmission Charging Regime – Treatment of Storage
0678F	Amendments to Gas Transmission Charging Regime – Treatment of Unprotected Entry Capacity Storage
0678G	Amendments to Gas Transmission Charging Regime including a Cost based Optional Capacity Charge
0678H	Amendments to Gas Transmission Charging Regime (Postage Stamp) including a Cost based Optional Capacity Charge
0678I	Amendments to Gas Transmission Charging Regime including Wheeling and an Ireland Security Discount
0678J	Amendments to Gas Charging Regime (Postage Stamp) including a Cost Based Optional Capacity Charge

**Responses invited by: 5pm on 08 May 2019**

**To:** [enquiries@gasgovernance.co.uk](mailto:enquiries@gasgovernance.co.uk)

<b>Representative:</b>	Jeff Chandler	
<b>Organisation:</b>	SSE	
<b>Date of Representation:</b>	6 May 2019	
<b>Support or oppose implementation?</b> (Please note you will be asked for your reasoning further below)	0678	Oppose
	0678A	Comment
	0678B	Oppose
	0678C	<b>Support</b>
	0678D	Oppose
	0678E	Comment
	0678F	Comment
	0678G	Oppose
	0678H	Comment
	0678I	Oppose
	0678J	Comment
<b>Expression of Preference</b> (Please note you will be asked for your reasoning further below)	<b>0678C</b>	

	678	A	B	C	D	E	F	G	H	I	J
Relevant Objective											
a	Negative	Negative	Negative	<b>Positive</b>	Negative	Positive	Positive	Negative	Negative	Negative	Negative
b	Negative	Negative	Negative	<b>Positive</b>	Negative	Positive	Positive	Negative	Negative	Negative	Negative
c	Positive	Positive	Positive	<b>Positive</b>	Positive	Positive	Positive	Positive	Positive	Positive	Positive
d	Negative	Positive	Negative	<b>Positive</b>	Negative	Negative	Negative	Negative	Positive	Negative	Positive
e	n/a	n/a	n/a	<b>n/a</b>	n/a	n/a	n/a	n/a	n/a	n/a	n/a
f	n/a	n/a	n/a	<b>n/a</b>	n/a	n/a	n/a	n/a	n/a	n/a	n/a
g	Negative	Negative	Negative	<b>Positive</b>	Negative	Positive	Positive	Negative	Negative	Negative	Negative
Charging Objective											
a	Negative	Negative	Negative	<b>Positive</b>	Negative	Positive	Positive	Negative	Negative	Negative	Negative
aa	n/a	n/a	n/a	<b>n/a</b>	n/a	n/a	n/a	n/a	n/a	n/a	n/a
b	Negative	Positive	Negative	<b>Positive</b>	Negative	Negative	Negative	Negative	Positive	Negative	Positive
c	Negative	Positive	Negative	<b>Positive</b>	Negative	Negative	Negative	Negative	Positive	Negative	Positive
d	n/a	n/a	n/a	<b>n/a</b>	n/a	n/a	n/a	n/a	n/a	n/a	n/a
e	Negative	Negative	Negative	<b>Positive</b>	Negative	Positive	Positive	Negative	Negative	Negative	Negative
Summary	Oppose	Comment	Oppose	<b>Support</b>	Oppose	Comment	Comment	Oppose	Comment	Oppose	Comment

**Standard Relevant Objective:**

The summary below lists the Relevant Objectives that apply to the modifications. Only those modifications that positively impact the Relevant Objective are listed, those that have a negative impact are not listed.

a) Efficient and economic operation of the pipe-line system

Only providing a 50 % discount to storage charges will curtail storage operations and will be detrimental to the efficient operation of the network.

Only those mods with an 80 % discount for storage are efficient. Based on analysis carried out by Storengy and WWA there is a clear relationship between the physical operation of storage facilities and the pipe-line system. The strong correlation between aggregate gas demand and storage withdrawals/injections means that National Grid, in its role as SO, benefits from gas storage, at no cost. The flexibility provided by gas storage provides direct support to National Grid in its role as system balancer through; contributing to linepack management and reduced activity and costs associated with National Grid's participation in the balancing market (OCM).

**678 Modifications furthering relevant objective: C,E,F.**

b) Coordinated, efficient and economic operation

Storage provides support to the entire network. Its proximity to demand and flow response to changes in aggregate demand levels ensures that overall system pressures are supported, benefiting the NTS and connected networks. In the absence of storage, marginal gas supplies would be more distant from demand which in turn may result in operational issues for DNs, in the absence of additional investment in the NTS.

**678 Modifications furthering relevant objective C,E,F.**

c) Efficient discharge of the licensee's obligations.

**All modifications** efficiently discharge licencees' obligations.

d) Securing of effective competition.

Only modifications with a Postage Stamp (PS) Reference Price Methodology (RPM) secure effective competition, all Capacity Weighted Distance (CWD) modifications are negative as charges are not cost reflective, create distortions and are detrimental to efficiency and competition. These distortions have the potential to increase costs to customers by up to £300m/yr relative to a PS RPM as explained later in the response.

**678 Modifications furthering relevant objective: A,C,H,J.**

g) Compliance with the Regulation

SSE has shared QC legal advice with industry that concludes: 1. for the treatment of pre April 2017 capacity contracts, while the reserve price was a fixed component of the tariff level there was an expectation of floating Revenue Recovery Charges (RRC) at the time of agreeing the contracts. The UNC foresaw that the RRC would change over time, since it was a fluctuating adjustment to the allowed revenue. Moreover, in practice the RRC charged did vary over time. As a result we believe that all existing contracts, except storage, should be exposed to Revenue Recovery Charges going forward as a matter of law.

2. Only a 1<sup>st</sup> October effective date complies with CAM and TAR code.

**678 Modifications furthering relevant objective: C,E,F**

<p><b>Charging Methodology</b> <b>Relevant Objective:</b></p>	<p><b>The summary below lists the Relevant Objectives that apply to the modifications. Only those modifications that positively impact the Relevant Objective are listed, those that have a negative impact are not listed.</b></p> <p>a) compliance with the charging methodology results in charges which reflect the costs incurred by the licensee in its transportation business</p> <p>Those mods with an 80 % discount for storage better reflects the costs incurred by the licensee. Only providing a 50 % discount to storage charges will curtail storage operations and will be detrimental to the efficient operation of the network.</p> <p>As set out in the WWA paper the fact that flows to and from offtakes located close to storage facilities are cheaper than the cost of flowing gas to the same offtakes, but via storage (including a 50% discount), suggests that a 50% discount is not cost reflective. The application of an 80% discount ensures that the costs incurred under these two flow scenarios are equivalent.</p> <p>Finally, in relation to the application of Revenue Recovery Charges, the proposals recommend that no charges are applied to storage. This approach is consistent with the findings of Ofgem in its Gas Transmission Charging Review on the basis that flows to and from storage have already made a contribution to historical cost recovery.</p> <p><b>678 Modifications furthering relevant objective: C,E,F.</b></p> <p>b) the charging methodology properly takes account of developments in the transportation business</p> <p>Proposal takes into account developments which take place in the transportation business, in particular that the network has spare capacity and only limited expansion maybe required. Considering the lead time required for the development of new pipelines , assumptions on Postage Stamp as a suitable RPM are robust for 5 years.</p> <p><b>678 Modifications furthering relevant objective: A,C,H,J.</b></p>
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**Charging Methodology  
Relevant Objective  
(continued):**

- c) compliance with the charging methodology facilitates effective competition  
Only modifications with a Postage Stamp (PS) RPM secure effective competition, all CWD modifications are negative as charges are not cost reflective which create distortions and are detrimental to efficiency and competition. These distortions have the potential to increase costs to customers by £300m/yr relative to a PS RPM.  
**678 Modifications furthering relevant objective: A,C,H,J.**
- e) Compliance with the Regulation and any relevant legally binding decisions of the European Commission and/or the Agency for the Co-operation of Energy Regulators  
SSE has shared QC legal advice with industry that concludes: 1.for the treatment of pre April 2017 capacity contracts, while the reserve price was a fixed component of the tariff level there was an expectation of floating Revenue Recovery Charges (RRC) at the time of agreeing the contracts. The UNC foresaw that the RRC would change over time, since it was a fluctuating adjustment to the allowed revenue. Moreover, in practice the RRC charged did vary over time. As a result we believe that all existing contracts, except storage, should be exposed to Revenue Recovery Charges going forward as a matter of law.  
2. Only a 1<sup>st</sup> October effective date complies with CAM and TAR code.  
**678 Modifications furthering relevant objective: C,E,F**
- Please refer to the rest of the consultation response for a more detailed explanation.

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

**678 - Oppose**

**1. Market Distortion by CWD**

The CWD modification as raised by National Grid results in market distortions driven by entirely fictitious “use” of the system derived from the distance element of the CWD model. The distortions are likely to have a detrimental impact on competition. The CWD approach results in locational diversity in charges which distort market signals and could result in inefficient markets costs of over £300M/yr, compared with Postage Stamp charges, for wholesale gas and electricity markets as shown in the “Impacts and Costs” section of this response.

Additionally, charges derived from the CWD methodology will only be stable and predictable if the FCC values are stable. The Postage Stamp RPM will produce charges that are inherently more stable due to the nature of the calculation. More predictable and stable charges will facilitate competition because, all else being equal, greater cost certainty will lower risk and will result in lower cost of capital for Shippers which will reduce barriers to entry and facilitate competition.

Most CWD mods fail the cost allocation test established by Article 5 TAR NC (G and I pass). This is the only quantitative test in the TAR code to assess against the risk of cross subsidy and non-

discrimination. This non-compliance with the TAR code will require an explanation of how cross border trade is not hindered and how cross subsidy is avoided by Ofgem in any final decision.

## **2. 50% storage Discount and storage curtailment**

Only a 50 % discount has been proposed by National Grid. However, a discount of 80 % for storage is compliant with EU law which requires a minimum 50 % discount. The value of 80% is justified in the report published by Waters Wye for the Gas Storage Operators Group. <https://gasgov-mst-files.s3.eu-west-1.amazonaws.com/s3fs-public/ggf/book/2019-02/WWA%20GSOG%20NTS%20CapacityDiscountsReport270219finaldraftv0%205.pdf>

SSE's gas storage has been a loss making business for a number of years and the new charging regime will increase costs. For storage operators it is a question of how long assets can be maintained without the prospect of making an economic return. Curtailment of gas storage will result in higher system operating costs, less security of supply, higher price volatility and higher priced gas for customers. Increasing the discount from 50% to 80% would only increase costs to all other users by 1-2%, considerably less than the value of enhanced security of gas supply.

## **3. Compliance with TAR and RRC applied to Existing Contracts**

National Grid proposes to exempt pre April 2017 (existing) contracts from Revenue Recovery Charges (RRC). SSE has shared QC legal advice with industry that concludes, for the treatment of pre April 2017 capacity contracts, while the reserve price was a fixed component of the tariff level there was an expectation of floating RRC at the time of agreeing the contracts. The UNC foresaw that the RRC would change over time, since it was a fluctuating adjustment to the allowed revenue. Moreover, in practice the RRC charged did vary over time. As a result we believe that all existing contracts, except storage, should be exposed to Revenue Recovery Charges going forward as a matter of law. We propose all storage capacity, with the exception of own use gas, is exempt from RRC in line with Ofgem's Preferred Policy Position in November 2015.

## **4. FCC in the UNC**

National Grid propose the FCC is determined in a separate methodology, not in the UNC. As a result users will have restricted influence which limits effective Governance. The FCC methodology is a key part of the overall charging arrangements in that it establishes a set of data inputs to the Reference Price Methodology. The charging arrangements were included in the UNC as part of a code governance review several years ago and so to ensure adequate governance this methodology should be inserted within the code too.

## **5. 1<sup>st</sup> October Effective date**

National Grid propose that the effective date of charges from the new RPM can be at any time. SSE have shared QC advice on timing with Industry<sup>5</sup>. The effective date of new charges needs to comply with existing EU Capacity Allocation law which requires that charges for Interconnectors are published effectively before 1<sup>st</sup> June, and that the Gas Year starts on 1<sup>st</sup> October. Furthermore, EU Tariff code law requires that the same charging methodology must apply to all entry/exit points. Given the consultation process required to be undertaken by Ofgem we do not think sufficient time remains to have revised charges effective from 1<sup>st</sup> October 2019. A new target effective date of 1<sup>st</sup> October 2020 gives industry sufficient time to prepare for the fundamental change being introduced so that distortions to the market do not lead to increased costs to customers.

### **678A -Comment**

RWE recommend a Postage Stamp RPM and therefore addresses issue 1 identified with 678 above.

However, 678A shares issue numbers 2, 3, 4 ,5 identified with 678 above.

### **678B -Oppose**

The Centrica modification shares issues with 678 except issue 4.

### **678C - Support**

The SSE modification 678C addresses the issues 1 to 5 identified with 678 above.

In particular, Ofgem stated in the 621 rejection letter the PS RPM *“has the effect of combining both revenue recovery charges and forward-looking signals into a single capacity-based charge. Given low levels of anticipated new investment in gas network capacity in the near term, we anticipate this type of capacity charge would serve a predominantly revenue recovery function. We also note that in this context, the value of forward-looking signals is likely to be of lesser importance”*.

The proposed use of a PS methodology (with the CWD model as a counterfactual) is a fair, proportionate and non-discriminatory approach to the recovery of the allowed revenue and it is consistent with the approach adopted for the recovery of historic sunk network costs adopted in the Ofgem minded to decision in the Targeted Charging Review for the electricity market<sup>1</sup>.

The PS approach is not designed to reflect current and future expectations related to the “use” of the NTS and does not seek to influence its use (driven through market behaviour). These positive attributes are reflected by the majority of other European States having adopted a PS RPM and consequently approved by ACER.

The negative impacts of a CWD RPM compared with a PS RPM are summarised below:

- i. CWD results in charges that on average are higher at beach terminals than other entry point groups. This might be distortionary and result in higher priced NBP gas as charges are incrementally passed through on a marginal basis or cheaper sources of gas are frozen out of the market.
- ii. Existing contracts have significantly lower charges than new entrants and this might be discriminatory.
- iii. Scotland has higher DN charges than other points, this is not cost reflective given that most gas used to supply Scotland will enter at St Fergus and this may be politically sensitive.
- iv. St Fergus has higher entry costs under CWD than PS, given that Norway is a marginal supplier to GB this has the potential to increase NBP gas price and therefore costs to customers by up to £10/year /customer or £190 M/Yr.

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<sup>1</sup> See <https://www.ofgem.gov.uk/publications-and-updates/targeted-charging-review-minded-decision-and-draft-impact-assessment>



- v. Peterhead has higher exit costs under CWD than PS, given that it may set the marginal clearing price in a future Capacity Mechanism auction this has the potential to impact customer levies and costs to customers by up to £5/year /customer or £117 M/Yr.

Supporting information to the above statements is provided in the “Impacts and cost” section of this response.

Finally, in developing a postage stamp approach the following Ofgem views are relevant<sup>2</sup>

- i. *“cost-reflectivity is more relevant to forward-looking charges than revenue recovery charges”;*
- ii. *“the following principles are relevant for assessing revenue recovery charges: i) reducing harmful distortions, ii) fairness to end consumers and iii) proportionality and practical considerations”*
- iii. *“Only a limited proportion of the costs of a meshed network are directly attributable to particular points, and therefore a substantial proportion of NGGT’s revenue requirement cannot be unambiguously attributed to individual entry and exit points.”*
- iv. *“distance-based allocation of revenue recovery charges (i.e. CWD methodology and variants on CWD) would attribute a greater proportion of network costs to points on the network associated with longer average distances to other points on the network. Our current view is that there are several potential weaknesses with using distance as a factor for setting the reference price:*
  - a. *Setting higher charges to those bringing gas onto and taking gas off the system at points which are located further away would increase incentives on those users to reduce their usage of the network, for which there are unlikely to be any short to medium term associated cost savings.*
  - b. *The distances used in the CWD methodologies are typically averaged across all points for the purposes of setting prices, and the actual costs of a particular entry point to a particular exit point might not be “real” (i.e. such physical flows may never occur). Shippers book entry and exit capacity independently and nominate flows without specifying specific routes and therefore it is very difficult to allocate flows to specific assets. This type of treatment of distance is therefore unlikely to generate prices that are accurately cost-reflective of the physical transportation routes actually used. Although as we consider the charges resulting from the RPMs to be largely functioning as revenue recovery charges, cost-reflectivity is less relevant in any case.*
  - c. *Using distance in setting transmission entry and exit charges would mean those consumers who are located in more remote locations would pay higher transmission charges for entry and exit (other things being equal). This may not be considered a fair outcome as those consumers are not driving significant additional costs from their use of a shared network that is already built and that has spare capacity available.”*

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<sup>2</sup> See <https://gasgov-mst-files.s3.eu-west-1.amazonaws.com/s3fs-public/ggf/page/2018-12/Ofgem%20Decision%20Letter%200621.pdf>

### **Optional Charge**

Since there is a review group 0679R considering the optional charge, SSE considers that one can be developed later. If a 1<sup>st</sup> October 2020 Effective date is chosen for any proposal then we consider there is sufficient time for 0670R to progress work on an optional charge for implementation on the same date. This should not preclude 0678 variants that do not include an optional charge being implemented. SSE is supportive in principle of an optional charge as it will avoid additional costs being paid by customers when private pipelines are built which bypass the NTS. Examples are given in the Ofgem question section of this response, that show costs to remaining customers could increase by up to £60m/year with three short bypass pipelines constructed.

### **678D - Oppose**

The Eni modification shares the same issues with 678.

### **678E - Comment**

The Gateway LNG modification shares issues with 678, except for issues 2 and 3.

### **678F - Comment**

The Storengy UK modification shares issues with 678, except for issues 2 and 3.

### **678G - Oppose**

The Vitol SA Geneva modification shares issues with for 678.

### **678H - Comment**

The EP UK Investments modification recommends a Postage Stamp RPM and therefore addresses issue 1 identified with 678 above.

However, 678H shares issue numbers 2, 3, 4 ,5 identified with 678 above.

### **678I - Oppose**

The Gazprom M&T modification shares issues with 678, except for issues 4 and 5.

### **678J - Comment**

The South Hook Gas Co. modification recommends a Postage Stamp RPM and therefore addresses issue 1 identified with 678 above.

However, 678J shares issue numbers 2, 3, 4 ,5 identified with 678 above.

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

SSE have shared QC advice on Effective Dates with Ofgem and industry.

<https://gasgov-mst-files.s3.eu-west-1.amazonaws.com/s3fs-public/ggf/book/2019-04/SSE%20Effective%20Date%20Legal%20Advice.pdf>

The Effective Date of new charges needs to comply with existing EU Capacity Allocation law that requires that charges for Interconnectors are published effectively before 1<sup>st</sup> June in any year, and that the Gas year starts on 1<sup>st</sup> October. Furthermore, EU Tariff code law requires that the same charging methodology must apply to all entry/exit points. Given the consultation process required to be undertaken by Ofgem we do not think sufficient time remains to have revised charges effective from 1<sup>st</sup> October 2019. A new target effective date of 1<sup>st</sup> October 2020 gives industry sufficient time to prepare for the fundamental change being introduced so that distortions to the market do not lead to increased costs to customers.

In more detail:

Only a 1<sup>st</sup> October implementation date can apply. This is to ensure compliance with TAR Article 6.3 to avoid different charging methodologies for IPs and non-IPs and compliance with CAM Article 9.

CAM Article 9.2 defines yearly standard capacity product as for a gas year starting on 1st October. UNC GTC 2.2 defines gas year and capacity year as from 1st October.

Further, EU TAR NC Article 12.3 states prices published according to EU TAR NC Article 29 are binding for the gas year. Indeed EU law for chapters VI and VIII of EU TAR are already in force and define the gas year consistent with CAM. This is evidenced below by National Grid in slides 23 & 24 which state GB is already compliant with publication requirements of EU TAR NC chapter VIII Art 29-32.

<https://gasgov-mst-files.s3.eu-west-1.amazonaws.com/s3fs-public/ggf/page/2017-09/Tx%20WG%20September%202017.pdf>

EU TAR NC Article 32 states EU TAR NC Article 29 information must be published 30 days before the annual yearly capacity auction, so early June for July auction and EU TAR NC Article 30 no later than 30 days before the tariff period.

As stated, EU TAR NC Article 29 a (i) includes reserve prices until at least the end of the gas year beginning after the annual capacity auctions, for standard capacity products for firm capacity.

Standard capacity products in CAM article 9 includes yearly, quarterly monthly daily and within day.

Therefore, once these are set for IPs, they cannot be changed within year.

In-addition, if IPs and non-IPs were to be treated differently by having different effective dates and therefore different charging RPMs this would not be complaint with Article 6 of EU TAR NC. Therefore, to be compliant with CAM and EU TAR NC only an effective date of 1<sup>st</sup> October is permissible.

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

If a RPM based on CWD rather than Postage Stamp is implemented, annual cost increases to the wholesale markets of gas and supplier levy costs to customers for electricity of up to £193 M and £117M respectively are expected. Supporting analysis is included below:

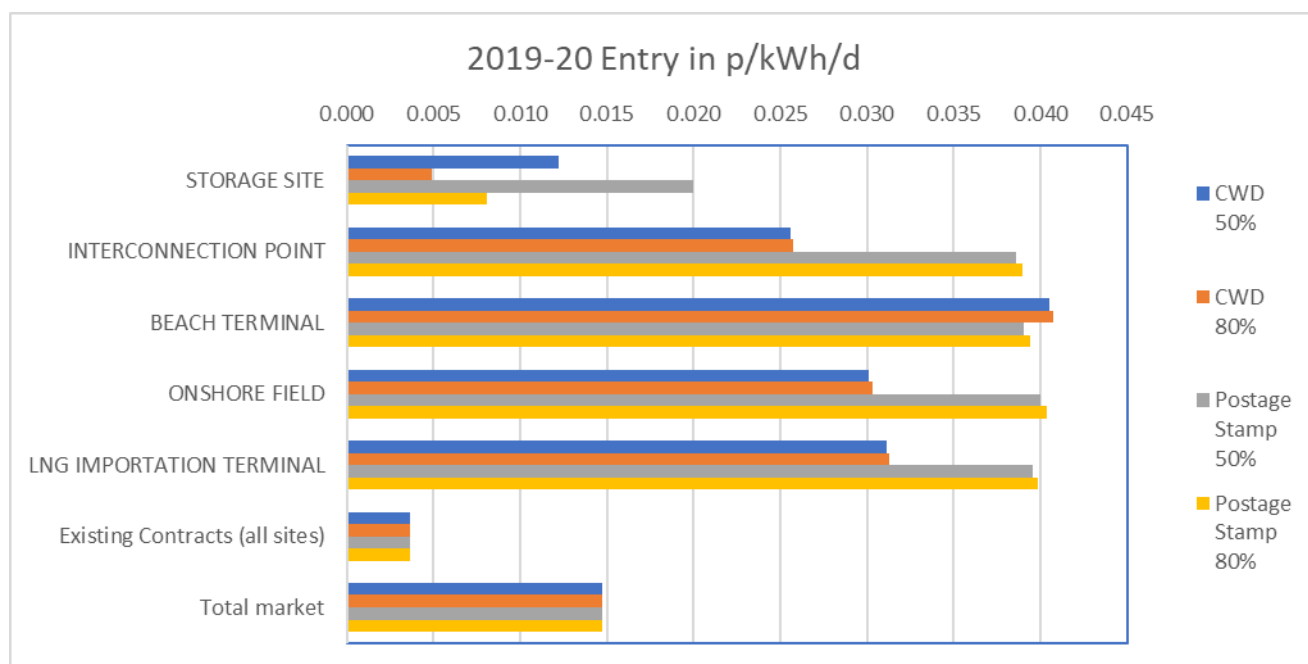
Charges have been calculated using the same model, FCC input data and booking assumptions provided by National Grid on 15 March. Only charges for 2019/20 have been calculated given the uncertainty of booking behaviour and the different allowed revenue in other years that make year on year comparisons less meaningful.

### Average Entry Charges

The graphic below shows the average Entry charges by customer type for the main modification groupings. i.e CWD or Postage Stamp and the size of discount for storage.

It can be seen that:

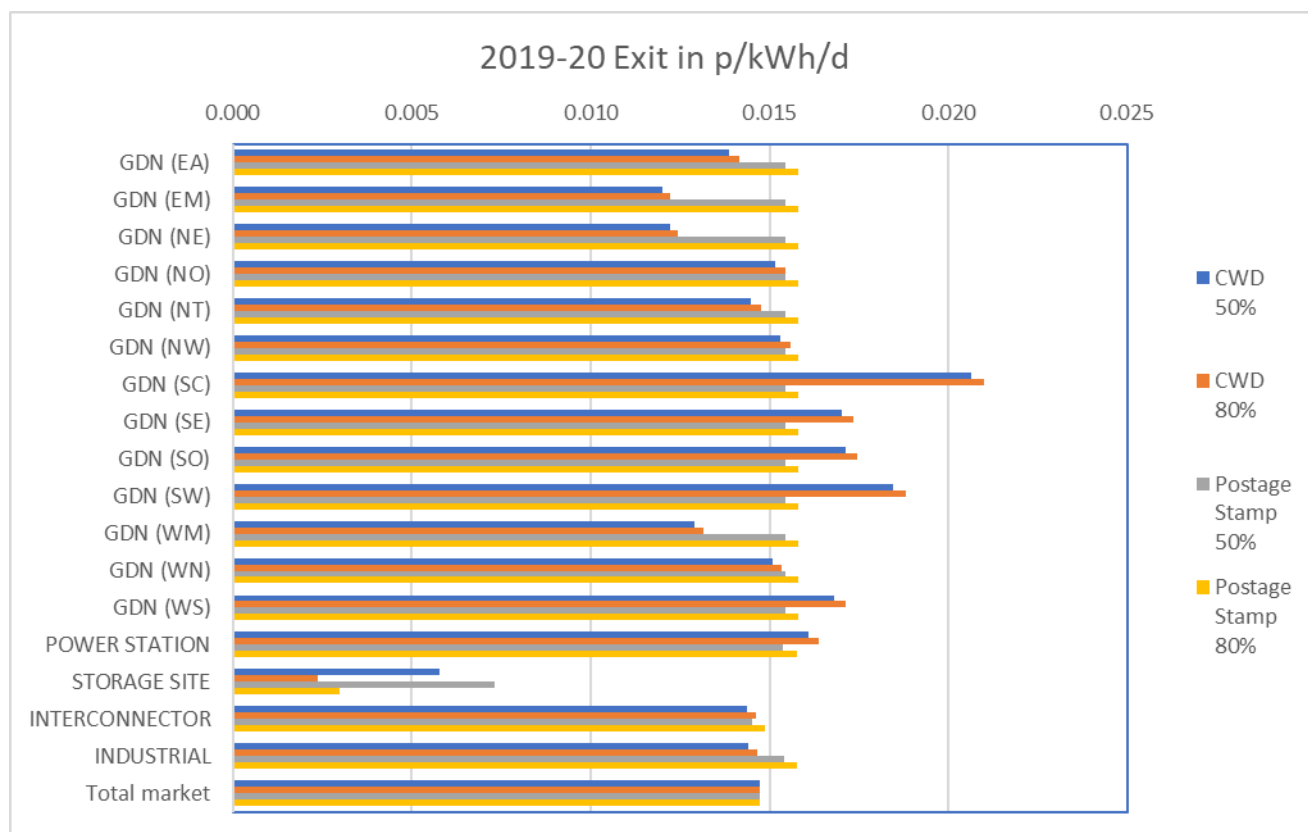
- the Entry charges for customer groups for PS are close together whereas CWD penalises Beach Terminals, relative to other CWD groupings, with higher charges. This is unfair and discriminates against a source of supply.
- Existing contracts are lower than all future costs that new entrants will be exposed to. This may be unduly discriminatory and undermine effective competition by favouring existing contract holders with lower costs for the same capacity use.
- Separately, applying a RRC to all points, except storage, is important because it will narrow the cost disadvantage between new entrants and existing capacity holders. This will improve competition. In-addition, it is the only compliant implementation of EU TAR NC Article 35 which concerns protection of existing contracts and the application of a RRC, as discussed later in the Ofgem Questions section of the response document.



### Average Exit Charges

The graphic below shows the average Exit charges by customer type for the main modification groupings. i.e CWD or Postage Stamp (PS) and the size of discount for storage.

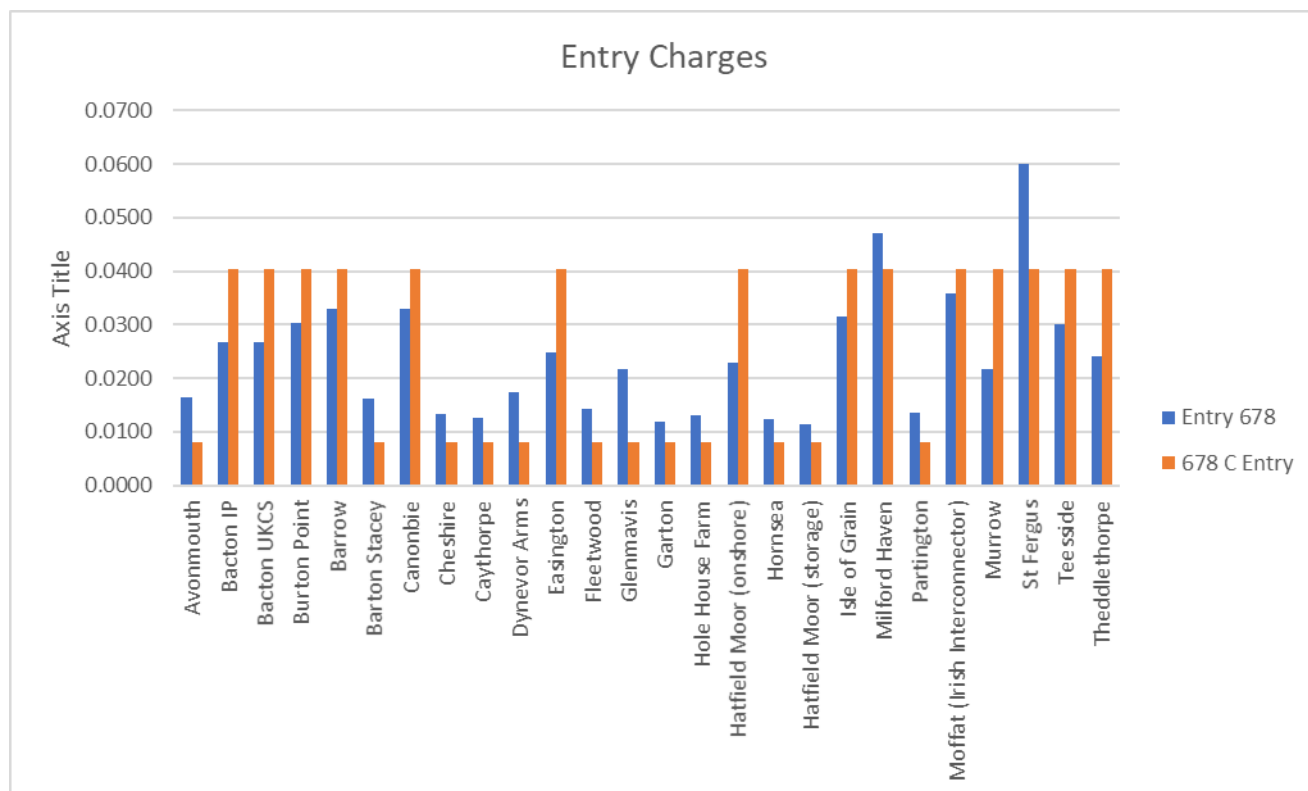
The Exit charges for customer groups for PS are close together whereas CWD has higher charges for DN customers in Scotland and SW. Given higher usage costs given climatic conditions in Scotland it might be considered unfair to ask customers to pay more for Transportation charges which are not cost reflective given the high percentage of GB gas landed at St Fergus. The storage costs are lower than other costs but will still result in an increase compared with current charges.



### Specific Entry Charges

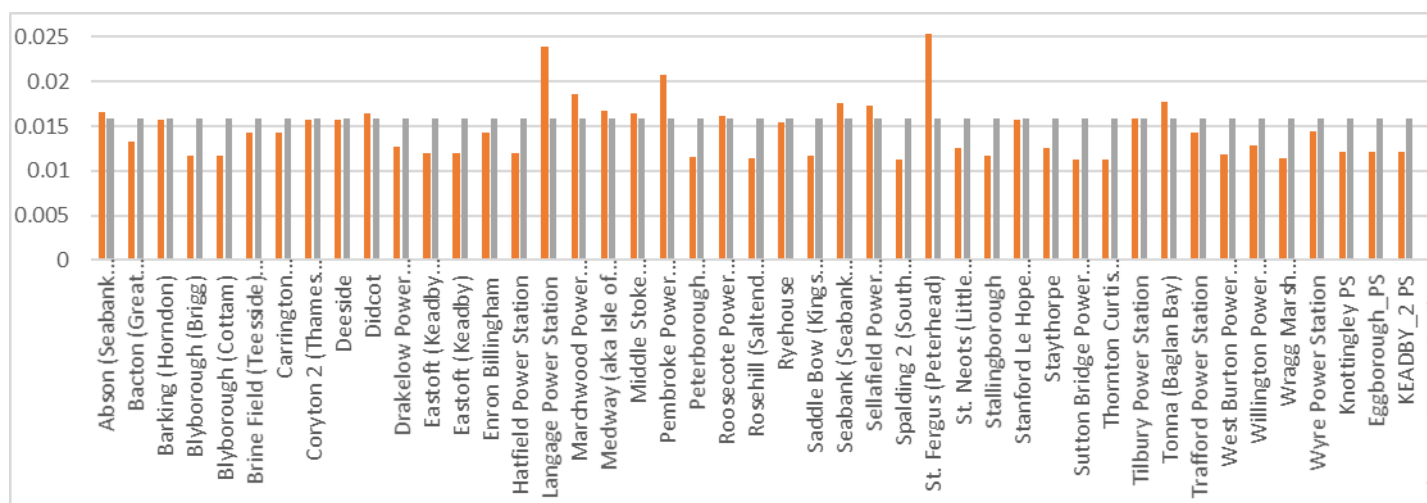
SSE's concern is the impact of an RPM which is not cost reflective and the subsequent distortive impacts on wholesale gas markets. NG will always recover allowed revenue but the increase in costs arising to customers from distortions to wholesale markets can be material. The PS will always minimise these distortions as all users pay the same amount and is therefore preferable. As expected, averages in the above graphics can be misleading for individual entry and exit points and therefore the next 2 graphics provide more detail for individual points with consequences for wholesale gas prices and which lead to increased costs to customers.

The Postage Stamp Entry costs are the same for storage and non- storage user groupings and therefore no distortion occurs. Whereas there are significant costs differentials and subsequent distortions under CWD, St Fergus is the highest by 50% compared with PS. Given that St Fergus is often the marginal supply for GB gas, this will lead to an increase in NBP gas price for CWD compared with PS of 0.02 p/kwh or 0.6 p/th. If St Fergus sets the marginal price of supply on each day ( supporting information below in Annex 1) then wholesale costs to customers will increase by 0.6p/th \* 33 bn therms /yr = £193 m/yr or £10/year/customer.



### Specific Exit Charges

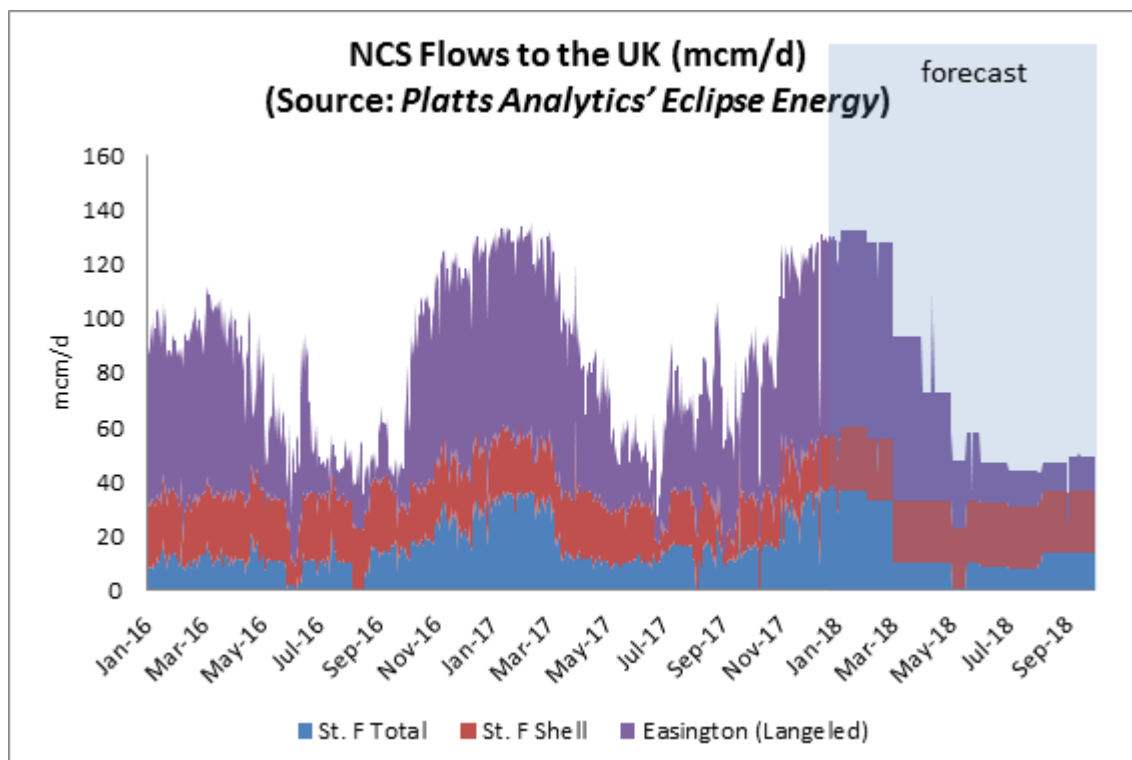
The Postage Stamp Exit costs are the same for all power stations and therefore no distortion to the wholesale electricity market occurs. Whereas there are significant costs differentials and subsequent distortions under CWD. Peterhead is the highest by 60% compared with PS and results in an increase in cost of 0.025-0.0154 p/kwh/d which equates to £2.3 /kW based on 73 GWh/day. If this plant were marginal and set the clearing price in the Capacity Mechanism auction then, all else being equal, the increase in cost across a typical 50 GW auction volume would be £117m/year charged to and paid by increases to customer bills.



A table is included in modification 678C, appendix 4, to show the amount of revenue collected by each customer grouping by main modification type.

### Annex 1: St Fergus Setting Marginal Price for GB NBP

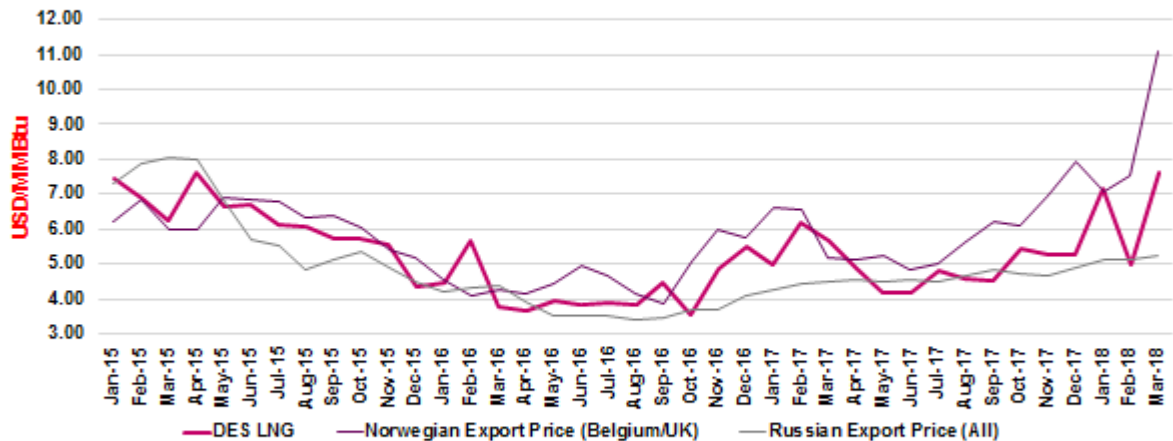
GB receives a material amount of gas from Norway and indigenous production through St Fergus, making it a key supply point and price setter for NBP price. St Fergus currently receives gas every day from the Norwegian Continental Shelf (NCS) as shown below:



Additionally, the chart below shows that Norway has been the highest priced marginal supplier to GB in 2018, this is expected to continue with a global surplus of LNG supply. It is therefore reasonable to expect any future costs associated with delivering gas from Norway to GB/EU to be passed on through to the NBP price.



## NWE competitive price landscape: DES NWE LNG is not always the most expensive



Source: Eurostat

S&P Global  
Platts

In the future, if Norwegian flows into St Fergus are incremental and discretionary on the day, then all else being equal, one can expect the marginal capacity cost to feed into the cost of wholesale gas at the NBP.

The link from the ACER publication below, shows on page 57, figure 31 the cost of transiting gas around Europe.

[https://acer.europa.eu/Official\\_documents/Acts\\_of\\_the\\_Agency/Publication/ACER%20Market%20Monitoring%20Report%202016%20-%20GAS.pdf](https://acer.europa.eu/Official_documents/Acts_of_the_Agency/Publication/ACER%20Market%20Monitoring%20Report%202016%20-%20GAS.pdf)

It indicates that the cheapest option to flow gas from Norway to GB is direct and not via Europe. Therefore, if we are to continue to receive gas on any day from the NCS, any increase in entry capacity costs at St Fergus will directly feed through into GB gas price.



## Consultation Questions Requested by the Authority

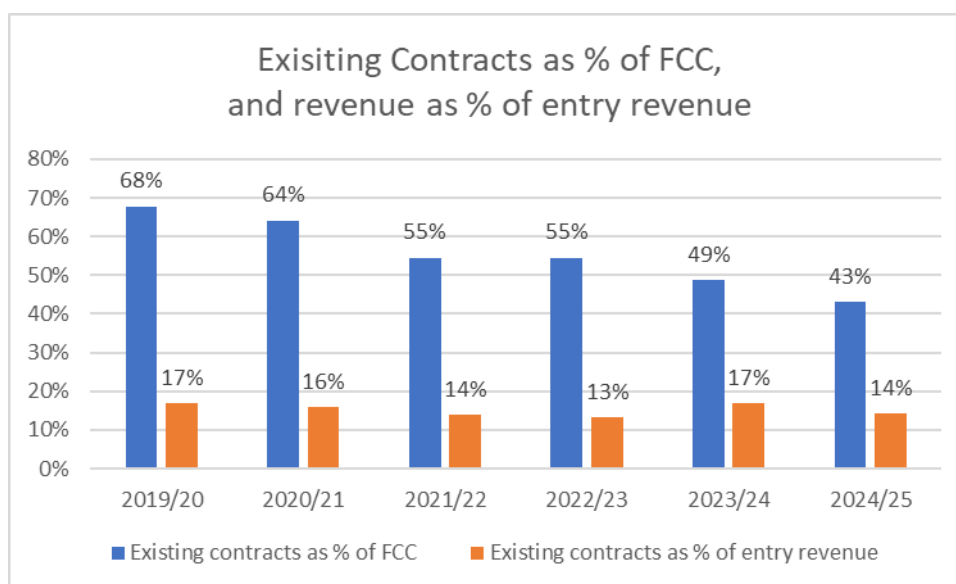
The Authority has requested that the following questions be considered by respondents when writing their responses.

### What impact, if any, do you think tariff differentials between existing and new contracts will have on users booking behaviour?

Little impact on booking behaviour but a competitive advantage for existing holders of capacity over new entrants.

The Baringa report<sup>4</sup> identifies that there are multiple influences on the wholesale price and hence customer welfare. However, the competitive advantage for existing contract holders with lower tariffs is acknowledged.

Firstly, it is useful to consider the magnitude of the issue. The chart below shows the disparity in the quantity of existing capacity and the revenue it recovers. In 2019/20 this implies that the remaining 83% of entry allowed revenue will need to be recovered from 32% of the FCC volume. This leads to the average price for newly purchased beach capacity being approximately 10x that of the average existing contract price<sup>3</sup>.



However, averages are not transparent and it is only once more detailed analysis is reviewed that greater insight can be gained.

Baringa address this in Figure 2 in their report<sup>4</sup> which provides a comparison of existing contract price and CWD / PS prices by entry point. It is useful to consider this in conjunction with Chart 12 from Baringa's report and with Chart 3 in National Grid's summary note<sup>56</sup>. This shows that the main points where flows exceeded existing contract bookings in 2017/18 were Bacton IP, Bacton UKCS, St Fergus and Teesside. The difference here between the existing contract price and the

<sup>3</sup> <http://www.gasgovernance.co.uk/0678/Analysis> see analysis by Vermillion published on 4 March

<sup>4</sup> <http://www.gasgovernance.co.uk/0678/Analysis> Baringa report published 8 April

<sup>5</sup> <http://www.gasgovernance.co.uk/0678/Analysis> Existing contracts summary not 8<sup>th</sup> April

<sup>6</sup> Baringa report Figure 12 shows that overbooking in 2021/22 is mostly limited to storage and LNG entry points

CWD / PS price is roughly x3-4 apart from St Fergus where the factor is close to 1 for PS and slightly less than 2 for CWD.

These numbers are much less than the headline value of x10 above but are still significant. **Given that incremental entry capacity at the above named entry points will have to be bought priced on the new RPM, the cost of capacity will rise and along with it the cost of gas at the NBP and costs to customers.** Therefore, existing capacity holders will have a competitive advantage over new entrants. Although not desirable, in terms of compliance with TAR code there is little that can be done.

The only proposals that go some way to address this are 0678C,E,F,G,H by applying revenue recovery charges on existing contracts (apart from storage).

**What date should the changes proposed by the modifications become effective and why?**

We have shared QC advice on timing with Ofgem<sup>5</sup>. The effective date of new charges needs to comply with existing EU Capacity Allocation law which requires that charges for Interconnectors are published effectively before 1<sup>st</sup> June, and that the Gas year starts on 1<sup>st</sup> October. Furthermore, EU Tariff code law requires that the same charging methodology must apply to all entry/exit points. Given the duration of the consultation process required to be undertaken by Ofgem we do not think sufficient time remains to have revised charges effective from 1<sup>st</sup> October 2019. A new target effective date of 1<sup>st</sup> October 2020 gives industry sufficient time to prepare for the fundamental change being introduced so that distortions to the market do not lead to increased costs to customers.

**The proposals have different specific capacity discounts for storage sites. What level of storage discount do you consider is appropriate and can you provide clear justification if the discount is greater than 50%.**

A discount of 80 % for storage is compliant with EU law which requires a minimum 50 % discount. The value of 80% is justified in the report published by Waters Wye for the Gas Storage Operators Group. Gas storage has been a loss making business for a number of years and the new charging regime will increase costs. For storage operators it is a question of how long assets can be maintained without the prospect of making an economic return. Curtailment of gas storage will result in less security of supply, higher price volatility and higher priced gas for customers. Increasing the discount from 50% to 80% would only increase costs to all other users by 1-2%, considerably less than the value of enhanced security of gas supply.

**Can you provide reasons why an NTS Optional Charge is or is not justified? If you consider an NTS Optional Charge is justified, which proposal do you prefer and why is it compliant with TAR NC?**

The NTS Optional Charge was introduced to disincentivise the development of private pipelines for routes which could be served by the National transmission system (NTS). The building and use of private pipelines would create missing money for NG and the NTS and this would need to be recovered from other capacity holders, leading to an increase in charges for all remaining NTS customers. The optional charge was introduced to avoid unnecessary investment in what may be duplicate pipelines. These principles remain relevant today, so an appropriate optional charge seems justified.

A number of proposals include the provision for an optional charge, and there is also review group 0679R considering the optional charge. If a 1<sup>st</sup> October 2020 Effective date is chosen for

any proposal then we consider there is sufficient time for 0670R to progress work on an optional charge for implementation on the same date. Therefore, this should not preclude 0678 variants that do not include an optional charge being implemented.

The proposals all provide for the optional charge to be capacity based and provide the same arrangements at IPs and non-IPs thereby addressing two of the issues in Ofgem's rejection letter of UNC proposal 0621.

Analysis on the revenue that could be avoided from just three offtake points that are very close to entry points is shown below:

	CWD 19/20 price	FCC 19/20	Capacity cost		CWD 19/20 price	capacity cost
	p/KWh/d	Kwh/d	£M		p/KWh/d	£M
Grain	0.0167	48,815,174	2,976,865	Isle of Grain	0.0405	7,216,103
Peterhead	0.0254	73,267,750	6,792,653	St Fergus	0.0601	16,070,691
Pembroke	0.0209	121,200,000	9,255,627	Milford Haven	0.0470	20,791,136
Total			19,025,145			44,077,930

Using the 2019/20 CWD prices and FCC values this gives a total of £61.5M or 9% of Transmission Services allowed revenue for that year. The value for postage stamp is £50M based on exit and entry charges of 0.0158 and 0.0405 respectively. If these three sites built private pipelines and took no gas from the NTS then this missing money would need to be recovered from other capacity holders, leading to an increase in charges for all customers. An optional charge for these sites would mean that this investment would not happen and that some revenue is collected. This would limit the price increase to other users using the NTS compared with the situation with no Optional Charge.

We note that the £61.5M figure above is similar with the values of 'under recovery' in the National Grid optional charge analysis<sup>7</sup>. We consider this supports the principle of an optional charge being a feature of the charging arrangements, whilst the detailed design seeks to strike a balance between the applicability of the tariff and the cost impact to other capacity holders.

### **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?**

Ofgem will need to seek its own legal view on compliance whilst noting QC advice has already been shared by SSE with the industry specifically on Revenue Recovery Charges applicable to pre April 2017 bookings and the Effective Date for charges to commence.

SSE has shared QC legal advice with industry that concludes, for the treatment of pre April 2017 (existing) capacity contracts, that while the reserve price was a fixed component of the tariff level there was an expectation of floating Revenue Recovery Charges (RRC) at the time of agreeing the contracts. The UNC foresaw that the RRC would change over time, since it was a fluctuating adjustment to the allowed revenue. Moreover, in practice the RRC charged did vary over time. As a result we believe that all existing contracts, except storage, should be exposed to Revenue Recovery Charges going forward as a matter of law. The fact that these charges will be capacity

<sup>7</sup> <https://gasgov-mst-files.s3.eu-west-1.amazonaws.com/s3fs-public/ggf/book/2019-04/Optional%20Charge%20Analysis%20%28National%20Grid%29%20v1.3.pdf>

based rather than commodity based is included in Article 35 of the EU Tariff code law which specifically includes both.

We propose all storage capacity, with the exception of own use gas, is exempt from RRC in line with Ofgem's Preferred Policy Position in November 2015.

As previously discussed in the answer to question two, any effective date other than 1<sup>st</sup> October would not be compliant with the requirements of CAM code and TAR code.

**It is proposed that National Grid Gas may review or update the Forecasted Contracted Capacity (FCC) Methodology following consultation with stakeholders, unless Ofgem (upon application by any Shipper or Distribution Network Operator) directs that the change is not made as per its powers under Standard Special Condition A11(18) of National Grid's Licence. Do you believe that this governance framework is fit for purpose? Please provide reasons for your answer.**

SSE notes that proposals 0678B and 0678C provide for the FCC methodology to be included within the UNC and hence subject to UNC governance which provides for stakeholders to raise proposals for change with defined, transparent and well understood processes for managing that change. This leads to improved governance.

The FCC methodology is a key part of the overall charging arrangements in that it determines a set of data inputs to the reference price methodology. The charging arrangements were included in the UNC as part of a code governance review several years ago and to ensure adequate governance this methodology should be inserted within the code too. If methodologies are not included in the UNC it leaves parties having to convince National Grid to progress a change, which it may or may not do, or raise a UNC modification proposal on a specific aspect of those statements as is the case with current UNC proposals 0667 and 0671.