Representation – Modification

UNC 0728/A/B/C/D (Urgent)

Introduction of a Conditional Discount for Avoiding Inefficient Bypass of the NTS

0728	Introduction of a Conditional Discount for Avoiding Inefficient Bypass of the NTS
0728A	Introduction of Conditional Discounts for Avoiding Inefficient Bypass of the NTS
0728B	Introduction of Conditional Discount for Avoiding Inefficient Bypass of the NTS with 28km distance cap
0728C	Introduction of a Capacity Discount to Avoid Inefficient Bypass of the NTS
0728D	Introduction of Conditional Discounts for Avoiding Inefficient Bypass of the NTS

Responses invited by: 5pm on 26 June 2020

To: enquiries@gasgovernance.co.uk

Please note submission of your representation confirms your consent for publication/circulation.

Representative:	Jasper Stevens
Organisation:	BBLC
Date of Representation:	25th June 2020
Support or oppose implementation?	Support 0728 - Support 0728A - Support 0728B - Support 0728C - Support 0728D - Support
Expression of preference:	*If either 0728, 0728A, 0728B, 0728C or 0728D were to be implemented, which would be your preference?* 0728D
Relevant Objective:	0728: **a)** Positive **c)** Positive **d)** Positive **e)** Positive **g)** Positive 0728A: **a)** Positive **c)** Positive

	d) Positive **e)** Positive **g)** Positive 0728B: **a)** Positive **c)** Positive **d)** Positive **e)** Positive **g)** Positive 0728C: **a)** Positive **c)** Positive **d)** Positive **e)** Positive **g)** Positive 0728D: **a)** Positive **c)** Positive **d)** Positive **e)** Positive **g)** Positive

Relevant Charging Methodology Objectives:	0728: **a)** Positive **aa)** Positive **b)** Positive **c)** Positive **e)** Positive 0728A: **a)** Positive **aa)** Positive **b)** Positive **c)** Positive **e)** Positive 0728B: **a)** Positive **aa)** Positive **b)** Positive **c)** Positive **e)** Positive 0728C: **a)** Positive **aa)** Positive **b)** Positive **c)** Positive **e)** Positive 0728D: **a)** Positive **aa)** Positive **b)** Positive **c)** Positive **e)** Positive

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

BBLC supports the economic and regulatory principle, set out in the EU Gas Regulation (2017/459), that duplication of gas transmission systems should be avoided. BBLC agrees that in most cases such duplication would result in uneconomic and inefficient outcomes. All of the 0728 proposals seek to put in place justified arrangements that seek to remove the commercial incentives on parties to construct such duplicate pipelines and therefore BBLC supports all of the Proposals to a greater or lesser degree.

The impact of bypassing the NTS on National Grid's revenue recovery and the average transportation charges levied on customers

BBLC notes that National Grid's revenue recovery arrangements means that as its network throughput increases the average charge per unit of gas transported reduces. Maximising the NTS throughput therefore benefits all customers. Any gas flows that could efficiently utilise the NTS, but choose instead to bypass National Grid's network due to constraints inherent within National Grid's charging methodology, reduces this benefit.

Arrangements that discourage, or reduce the incentives for, the construction of such 'bypass' assets therefore better facilitate the efficient use of National Grid's network, increases National Grid's revenue recovery and, through its Allowed Revenue licence arrangements, reduces the average transportation charge to customers.

BBLC notes that the current Optional Commodity Charge (OCC) was introduced, in part, to reflect the network situation at Bacton where the BBL Interconnector Offtake is a matter of a few hundred metres from a number of 'beach' gas delivery facilities. The costs of constructing and operating a short "bypass" pipeline in this situation would therefore be very low. If such a bypass were to be built then gas suppliers wishing to use the current BBL reverse flow capacity to deliver gas to the EU gas markets would be able to avoid the NTS completely. In such a situation National Grid would lose revenue and, as a result, the average transportation charge to other customers would need to increase to offset this lost revenue. Avoiding such bypass is therefore beneficial to GB end consumers.

The construction of such bypass pipelines is dependent on the economic business case for constructing and operating such pipelines versus the cost of other viable alternatives such as requesting and utilising a connection to the NTS. It is also reasonable for parties to consider maintaining both a connection to the NTS and constructing a bypass pipeline thereby benefitting from a physical connection to the NBP and having the option to avoid National Grid's charges where it is economic to do so. The decision on whether or not to construct a bypass pipeline is therefore not an ‘either / or’ decision and all costs, benefits and options would be considered and any decisions made would be kept under review as situations change.

Impact on cross border trading and market volatility

The BBL pipeline serves to foster cross border trading, competition and market integration. Shippers are incentivised to trade between markets where the price differential (arbitrage) between two markets is greater than the costs of transporting the gas between these markets. This trading activity benefits end consumers by reducing market volatility and price spikes and provides for more price certainty for shippers and suppliers.

The OCC arrangement that is currently applied to gas flows in the Bacton area serves to reduce the costs of moving gas between the GB and EU markets. This therefore also reduces the required magnitude of the market arbitrage opportunity, between GB and European markets, before shippers are provided with sufficient incentive to complete such cross-border trades. Therefore, the current OCC arrangements encourage shipper competition and cross-border trading and consequently will increase the utilisation and throughput of National Grid’s NTS network. It also reduces energy markets price volatility in the UK.

The pending removal of the current Optional Commodity Charge (OCC) regime from October 2020, as a result of the implementation of Modification 0678, will significantly change the economic incentives for gas flows in and around Bacton and cross-border flows between the GB and mainland European gas markets. This will therefore reduce the level of the competition and market benefits described above. According to National Grid’s data provided in their 0728 Proposal, shippers currently choosing to enter gas at a Bacton beach entry facility, and offtaking it into the BBL pipeline using the OCC arrangements, currently attract a “*maximum effective discount”* in the region of 90%. Removal of this discount would, firstly, reduce the number of market arbitrage opportunities and associated shipper incentives to trade between the GB and Mainland European markets. Secondly, it would disrupt the current tariff structures and add volatility to the markets and, thirdly, it would provide a strong incentive for some parties to construct third party pipeline(s) in this area.

BBLC will now set out its view on the various differentiating aspects of the alternative modification proposals:

Inclusion of Transportation Service (TS) and non-TS charges.

BBLC supports the inclusion of both TS and non-TS charges within the short haul arrangements. Cost comparisons between connecting to, and using, the NTS or constructing and using a third-party bypass pipeline will inevitably include a comparison of both the cost of TS and non-TS of the two options being considered. Therefore, in BBLC's opinion a short haul arrangement that takes both of these aspects into consideration is more closely aligned to the reality of the commercial considerations taking place when considering whether or not to construct a bypass.

BBLC also does not consider that National Grid's NTS operational charges are necessarily a "good proxy" for the operational charges of a bypass pipeline. BBLC believes that this is especially the case where such a bypass pipeline is short and uncomplicated. BBLC considers that such pipelines would typically involve less operational complexity than an average NTS pipeline and operational costs would therefore be lower in comparison. As such, BBLC considers that it is appropriate that arrangements that seek to address the drivers that incentivise parties to bypass the NTS should include both TS and non-TS aspects, especially where the maximum eligible distance for such new arrangements is short, as is the case with 0728D.

Distance

BBLC agrees that the application of any new short haul discount should take account of the materiality of the risk of bypass and also acknowledges that this is influenced by both distance and the volume of gas using the proposed short haul route. BBLC also agrees that there is a balance to be struck between offering such discounted services to one group of customers and not to others and the level of socialisation of such perceived subsidies. However, BBLC believes it is also true to say that without such discounts gas would ultimately seek to bypass the NTS and National Grid's charges to other customers would have to increase as a result in order the recover it's Allowed Revenue. Consequently, where there is a genuine risk of bypass, the provision of an adequate short haul discount is beneficial to both the applicant and the other users of National Grid's network. The balance to be struck is to provide the relevant shippers with sufficient incentive to avoid seeking to bypass the NTS, and therefore maximise the efficient utilisation of the NTS and National Grid's revenue recovery, whilst at the same time ensuring that the revenue recovered at least meets the costs incurred by National Grid in facilitating such flows.

BBLC is not in a position to judge the merits or otherwise of the various "distance" options within the 0728 alternative proposals. However, BBLC does consider that all of the various alternative proposals provide a more cost reflective tariff than would otherwise be the case post implementation of Proposal 0678A. BBLC also feels that, in comparison with the existing OCC regime, they also strike a more appropriate balance between the incentives provided to mitigate the risk of inefficient bypass of the NTS versus the potential loss of NTS transportation revenues, and subsequent increased charges to other consumers, if the NTS throughput was reduced as a result of such bypass pipelines being built.

Discount Curve methodology

BBLC notes that all the Proposals except 0728D use the same discount curve calculation and also restrict the minimum discount to 10%. BBLC agrees in principle that it is appropriate that the amount of discount should vary according to the magnitude of the risk of bypass and that the risk magnitude is related to the length and complexity of the bypass pipeline required. BBLC also agrees with National Grid's proposal to use the formula published by the Council of European Energy Regulators in paper "*PROJECT CEER-TCB18 - Pan-European cost-efficiency benchmark for gas transmission system operators –17.07.2019*" as a proxy for pipeline construction costs. BBLC also concurs with the various Proposals' justification for limiting the minimum discount to 10%.

However, the discount curve arrangements inevitably add complexity to the arrangements and therefore, in the case of alternative 0728D, BBLC sees merit in removing this complexity where the maximum short haul qualifying distance is short, i.e. 5km. In such a situation BBLC considers that the risk magnitude / cost reflective benefits of applying the proposed discount curve methodology are significantly reduced and are therefore outweighed by the complexity it introduces.

Should the discount be applied to all eligible firm capacity (0728C) or only to utilised eligible capacity (0728, A, B and D)

On balance BBLC sees most merit in the view that the discount should only apply to network capacity that is utilised as this will incentivise efficient capacity booking and, by linking the discount to gas flows, also better connects it to actions that benefit the market as a whole and other users, i.e. NTS throughput.

Most preferred alternative - 0728D

All of the 0728 alternative Proposals, to a greater or lesser degree, restore the market and competition benefits offered by the current OCC arrangements applied at Bacton and therefore BBLC supports all of the 0728 Proposals. However, in BBLC's opinion, the Proposal that maximises the above advantages is Modification Proposal

0728D. By including discounts to both TS and Non-TS charges, and by proposing the highest combined percentage discount, this Proposal:

- minimises the costs of moving gas between the GB and European markets and therefore maximises the opportunity, and incentives, for cross-border trading and market competition,
- by including both TS and Non-TS charges it best reflects the investment decision parameters for constructing bypass pipelines, and
- by setting the short haul distance to 5km it limits the application of the new short haul arrangements to a minimum.

If it is considered that non-TS charges should be excluded from any short haul calculation then BBLC believes that National Grid's Proposal would then best meet the relevant objectives in comparison to the alternative Proposals that also exclude non-TS charges.

Relevant Objectives assessment:

a) Efficient operation of pipeline system

Positive – All of the 0728 Proposals seek to avoid inefficient bypass of National Grid's network and therefore increase the use of it. As stated earlier in this response, the EU Gas Regulation (2017/459) considers that duplication of assets is in general an inefficient outcome and therefore by seeking to avoid such an outcome all of the Proposals better facilitate this relevant objective.

c) Compliance with Licence obligations.

Positive - Standard Special Condition A5(5) of National Grid's Licence sets out the relevant charging methodology objectives and BBLC considers that these objectives are better facilitated by all of the Proposals for the reasons set out later in this response.

d) Competition.

Positive – With particular reference to the gas network infrastructure at Bacton, the current OCC short haul arrangements facilitate cross border trading and market integration. These current arrangements will shortly be removed by the implementation of Proposal 0678A. By seeking to re-introduce short haul arrangements all of the Proposals will facilitate increased cross-border trading opportunities and therefore also increase competition between shippers and between Interconnector Operators.

e) Provision of reasonable economic incentives for relevant suppliers to secure that the domestic customer supply security standards are satisfied.

Positive - The increased transportation costs that will be incurred by shippers and suppliers if short haul arrangements are **not** available at Bacton will adversely impact the efficient provision of Security of Supply (SOS) in GB. As the transportation route costs for GB shippers to access EU gas storage sites increase the cost of accessing the SOS benefits that these sites offer also increases. Such cost increases will either lead to reduced SOS provision or to an increase in the costs of the gas when it is supplied to the market. By seeking to avoid these cost increases all the Proposals better facilitate this objective.

g) Compliance with EU Regulations.

Positive – All of the Proposals seek to introduce charging adjustments that ensure that the charges levied on those shippers utilising a short haul service are reflective of the costs that they would incur if they were to construct and operate a bypass pipeline. As such BBLC considers that the Proposals meet the objectives of Art.13.1 of the EU Gas Regulation (715/2009). BBLC also considers that those alternatives which include both TS and Non-TS charges within the short haul discount assessment better facilitate compliance with this article of the Regulation as they better reflect the cost incurred of constructing and operating a bypass pipeline.

Art 13.1 also requires that "*Tariffs, or the methodologies used to calculate them, shall facilitate efficient gas trade and competition, while at the same time avoiding cross-subsidies between network users and providing incentives for investment and maintaining or creating interoperability for transmission networks."* BBLC considers that all the Proposals will better facilitate efficient gas trading and competition by adjusting tariffs, especially at Bacton, such that they better reflect the actual costs involved in moving gas between the entry facilities at Bacton and the Bacton Interconnectors. As such these charges will facilitate efficient trading between the GB and European gas markets. BBLC prefers Proposal 0728D as it considers that this Proposal strikes the right balance between facilitating efficient trading and competition and avoiding cross-subsidies between network users.

Art.13.2 requires that "*Tariffs for network access shall neither restrict market liquidity nor distort trade across borders of different transmission systems."* BBLC believes that the removal of the current OCC short haul arrangements will restrict market liquidity and distort efficient cross-border trading by imposing non-cost reflective charges on shippers for moving gas between the Bacton entry facilities and the BBL pipeline. The various 0728 Proposals seek to reintroduce arrangements that result in more cost reflective charges for such gas flows and as such they facilitate compliance with this Art 13.2.

EU Regulation 2017/459 recognises that "*Duplication of gas transmission systems is in most cases neither economic nor efficient*". By seeking to appropriately avoid incentives to construct such duplicate systems BBLC believes that all of the Proposals better facilitate compliance with this regulation.

EU Regulation 2017/460 Art. 17.1(c) states "*significant differences between the levels of transmission tariffs applicable for two consecutive tariff periods shall be avoided to the extent possible*". By aligning the introduction of a new short haul arrangement with the removal of the old OCC short haul arrangements, the pending magnitude of change in the tariff levels, that are applied to relevant short haul routes for two consecutive tariff periods, will be significantly reduced, thereby better facilitating compliance with this regulation.

Charging Relevant Objectives assessment:

a) Cost reflective charges

Positive - BBLC agrees with National Grid's assessment that "*Relevant Charging Methodology objective (a) is furthered by the introduction of a product that assists in providing an option to those more likely to consider a bypass of the NTS*". BBLC considers that all the 0728 Proposals seek to amend National Grid's charging methodology so that it will better reflects the costs incurred by National Grid in transporting gas along such short distances.

b) Taking account of developments in the transportation business;

Positive - BBLC agrees with National Grid's assessment of the Proposals' impact on this relevant charging objective.

c) Competition.

Positive – By introducing more cost reflective charges for moving gas between entry and exit points within the Bacton area the proposed short haul arrangements included in all of the 0728 Proposals will better facilitate competition between shippers, facilitate more efficient cross-border trading and better facilitate competition between Interconnector Operators by increasing the gas market arbitrage trading opportunities between the GB and Mainland European markets.

e) Compliance with EU Regulations.

Positive. See response on compliance with EU Regulations in the general relevant objectives section above. Also, BBLC considers that all of the 0728 Proposals facilitate such compliance by seeking to limit the application of the discount to those routes that represent a clear risk of constructing duplicate transmission assets and, for all but 0728C, by also limiting application to utilised flows. Such restrictions limit any undue cross subsidies for other users. On balance, whilst considering that all of the Proposals better facilitate this objective, BBLC considers that 0728D achieves the most appropriate balance when seeking to comply with Art.13.1 of the EU Gas Regulation (715/2009).

Implementation: *What lead-time do you wish to see prior to implementation and why?*

BBLC believes that the implementation date of any successful 0728 Proposal should be aligned with the date of the removal of the current OCC short haul arrangements. BBLC believes that it is important that these dates are aligned as any delay between the removal of the existing OCC arrangements and the implementation of revised arrangements would be detrimental to:

1) The efficient operation of National Grid's pipeline network, as throughput would be reduced as market arbitrage opportunities are reduced and / or shippers take steps to seek alternative transportation routes to markets and their customers, and,
2) Cross border trading and shipper competition for the reasons stated above.

Given that modification 0678A removes the current OCC arrangements and that Ofgem has directed this Modification to be implemented from 1st October 2020 BBLC proposes that the implementation date of 0728 should be aligned to this date.

Also, EU Regulation 2017/460 Art. 17.1(c) states "*significant differences between the levels of transmission tariffs applicable for two consecutive tariff periods shall be avoided to the extent possible*". By aligning the introduction of a new short haul arrangement with the removal of the old arrangement, the magnitude of change in the tariff levels, applicable to relevant short haul routes, for two consecutive tariff periods will be significantly reduced thereby better facilitating compliance with this regulation.

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

None

Legal Text: *Are you satisfied that the legal text will deliver the intent of the Solution?*

No Comment

Respondents are requested to provide views on the following points:

Q1: Respondents are requested to provide a view as to whether the solution provided within the Modification(s) is fully compliant with the relevant legislation (including, but not limited to, Articles 28-32 of the Tariff Network Code).

In BBLC's opinion all five of the Modification Proposals are compliant with relevant legislation and notes that National Grid has confirmed that it would be able to comply with the requirements of TAR Art. 28 to 32 should any of the Proposals be implemented according with the timetable set out in it. Furthermore, as set out in the relevant objective sections above, BBLC considers that the Proposals would enable the new tariff arrangements, post implementation of Proposal 0678A, to better reflect Articles 13.1 and 13.2 of the EU Gas Regulation (715/2009), Article 17.1 of EU Regulation (2017/460) and are aligned with the intent of EU Regulation 2017/459 in regard to avoiding inefficient duplication of network assets.

Q2: Respondents are requested to provide views on the proposed implementation date(s).

See previous comments in the "Implementation" section above.

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

No

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

We do not believe any further analysis is required.