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:	Nigel Sisman
Organisation:	Sisman Energy Consultancy Limited
Date of Representation:	26 June 2020
Support or oppose implementation?	Unfortunately it is not possible to assess the relative merits of each of the proposals against the “status quo” counter factual (the tariff regime under Modification 0678A applicable from 1 October 2020). The consultation and associated material include some estimates of “socialised costs”. Unfortunately these numbers do not take account of the effects of any loads that might bypass. This is important since under some of the proposals some of the loads should be expected to bypass based on National Grid’s Likelihood of Bypass indicator and its setting of the relevant charging function. Thus it is not possible to make reliable comparisons about the impacts of the proposals on the generality of customers. To enable any proposal to be recommended it needs to be demonstrated that the proposal is better than the “status quo”. If no load bypasses under the “status quo” then all of the options proposed would be inferior and should therefore be rejected. A more reasonable assumption, is that load would bypass in the “status quo” reference scenario. However the documentation does not provide any indication of the impact of loss of load under the “status quo”. Therefore no comparison between any of the options and the “status quo” can be made.

	Thus it has not been possible to make a recommendation in favour of any of the options and hence it would seem unsafe to make a recommendation to implement any of the proposals. However this does not mean that the "status quo" is an appropriate outcome; it is just that we don't yet have a proposal that has been demonstrated to be better than the "status quo" and which fairly balances the needs of all relevant actors and which satisfies the Relevant Objectives and Relevant Charging Methodology Objectives. The accompanying paper provides further background to this regrettable position.
Expression of preference:	No preference can be offered since it is impossible to make an adequate comparison between the proposals.
Relevant Objective:	In respect of all proposals a), b), c), e) and f) are assessed as None However d) and g) are relevant to the consideration of all options. **d) securing of effective competition between relevant shippers** All of the proposals may have effects on gas trading that might not fully be appreciated. The removal of the OCC from 1 October 2020 will likely enhance the NBP as the preferred trading location for Users. The existence of the OCC has promoted beach trading since it generates an opportunity to reduce transportation costs. This will have fragmented liquidity potentially to the detriment of competition between shippers. This might not have been such a problem were the effective costs of transportation a pass-through cost to all customers. However that has not been the case with respect to the OCC benefits associated with NTS direct connects. Increasing awareness of the OCC means that increased numbers of customers are now receiving a share of the benefits of the cheaper tariffs available via the OCC, however the rest of the benefit is likely shared between Users trading at the beach who have developed to optimise this opportunity arising from the OCC. The removal of the OCC from 1 October 2020 will address this issue. Implementation of any of the proposals would reintroduce a discount on transportation costs which would restore the possibility of a distortion in trading associated with the supply of

	gas to end consumers on eligible routes and the risks of an appropriate benefit of reduced transportation charges not feeding through to end customers associated with the eligible routes. The note accompanying this response has suggested that an appropriate solution to avoid inefficient by-pass is desirable but if any of the Modification 0728 options (or a variant thereof) is introduced then it would be prudent to make public the uptake of the routes where Users have elected to receive the reduced prices. This would mitigate the risk that the benefits are not passed through to customers. Therefore should Ofgem decide to implement any of the proposals it might want to consider indicating the desirability of a Modification Proposal to secure appropriate transparency of the individual routes availing of the discounted price opportunity. **g) 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** The tariff regime to apply from 1 October 2020 is compliant. The document attached to this response provides more background on the compliance risk areas. In summary it raises two points where the proposals introduce doubt about compliance: firstly that the options might be prohibited because they are calculated on the basis of “contract path” within the meaning of Article 13 of the Gas Regulation (715/2009) and “transport path” within Recital 19, and secondly, that the proposals define a reduced price, and therefore dual pricing, associated with the standard firm service which the respondent understands is prohibited by Gas Regulation (715/2009) and conflicts with the longstanding intent of the Commission and which is also reflected in the EU Tariff Code (2017/460). Whilst compliance is asserted in the proposals it is important that compliance is adequately justified rather than have significant risk of an upheld challenge should any decision to implement be taken.

Relevant Charging Methodology Objectives:	In respect of all proposals a), aa), b), c) and d) are assessed as None **e)** Negative – See Relevant Objective g) comment above and attached submission.

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

The attached document provides background to some of the issues at play in the consideration of these proposals. In essence, however, without an assessment of the extent of bypass and consequential loss of revenue under the "status quo" 1 October 2020 regime it is impossible to make an assessment as to whether any of the options offer an improvement. Furthermore the equitability of the discount function is doubtful, both in respect of within the eligible route class, and between the eligible route and non-eligible route classes. This may cast doubt on the appropriateness of Modification Proposals 0728/A/B/C. The attached paper includes specific analysis derived from the consultation material about the redistributive effects of Modification 0728D. This suggests that the discounts are so high that the generality of users would be better served via the 'status quo" arrangements if only a very small proportion of the eligible load did not bypass.

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

Should Ofgem be convinced of lawfulness and the appropriateness of a proposal then it should be implemented from 1 October 2020. Otherwise the industry should be encouraged to derive a better proposal that balances the interests of all stakeholders and demonstrates that this is the case. If the industry was to deliver such an outcome then it should be implemented as soon as possible; there should be no assumption that if October 2020 is missed that a better approach would need to wait until an October 2021 implementation.

That said it is important to acknowledge that the industry has known about the significant distortions associated with the OCC for six years and that during that period some Users and consumers will have benefitted from substantial cross-subsidy from domestic and smaller industrial and commercial consumers. It is however disappointing that an equitable approach to addressing the bypass issue has so far not been identified and justified.

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

Not assessed

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

Not assessed

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).

Some specific comments about the compliance assessment have been raised elsewhere in this response.

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

Addressed 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.*

The attached document indicates that the consultation has not been informed by any assessment about the extent to which bypass might occur under any of the proposals. Without this the real socialisation impacts of each proposal will be understated. The absence of this information means that whilst those consumers potentially eligible under any of the proposals might be accurately able to assess the impacts of each proposal for their individual transportation costs this is not the case for other consumers.

It is therefore crucial that the perspective of the generality of users particularly those domestic and industrial consumers, who have cross-subsidised the OCC service for so many years, are appropriately considered in the decision making process.

It is quite remarkable that the consultation material does not provide any indication of the risks of bypass that exist from 1 October 2020 when the new tariff regime is introduced. Without direct comparisons between the new regime and the 5 proposals (Modification Proposals 0728/A/B/C/D) it would seem difficult for Ofgem to decide that any of the options might represent an improvement.

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

It is crucial that, given that it is likely that without a solution to the bypass issue, that it is recognised that the optimum outcome will not necessarily be achieved with discounts that are designed to ensure that all load contains to utilise the NTS.

An example is extracted from the accompanying paper to illustrate this point:

Example to indicate Bypass implication assessment

Consider a case with 2 "bypass risk" sites, a genuine opportunity for bypass exists and the sites would need transportation prices of .08 and .01 respectively to continue on the NTS.

Assume overall revenue requirement of 9

Consider three scenarios:

Base	No discounts offered	So both at risk sites would bypass
Small discount	Discounted price of 0.08	Only one of the at risk sites would bypass
Larger discount	Discounted price of 0.01	All potential load would use the NTS

The following describe how the outcome would translate into the charge rate applicable to Non-Eligible Volumes.

		Pricing			Revenues		
	Volumes	Base payable	Small discount	Large discount	Base payable	Small discount	Large discount
Non Eligible Volume	90	0.100	0.0911	0.0978	9	8.2	8.8
At-risk site 1	10		0.0800	0.0100		0.8	0.1
At-risk site 2	10			0.0100			0.1
Allowed revenue entitlement	9				9	9	9

Shadings indicate where loads elect to bypass

Boxed area indicates impact of pricing choice given genuine bypass risks exist

The best outcome to Non-eligible volumes from a pricing perspective is achieved with a limited discount that will not ensure that all loads remain connected to, and utilise, the NTS.

The above illustrates that an appropriate consideration of the options requires an assessment of load that would be lost in the base scenario. It also indicates that offering discounts that are large may lead to substantial cross-subsidisation. The optimum outcome from the perspective of the non-eligible customers is to offer some discounts to retain some at risk load but that the optimum outcome might involve some loss.