

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:	Richard Pomroy
Organisation:	Wales & West Utilities
Date of Representation:	25 th June 2020
Support or oppose implementation?	<p>0728 - Oppose</p> <p>0728A - Oppose</p> <p>0728B - Oppose</p> <p>0728C - Oppose</p> <p>0728D – Oppose</p>
Expression of preference:	No preference we think that they are all flawed
Relevant Objective:	<p>0728:</p> <p>c) Negative</p> <p>d) None * <i>delete as appropriate</i></p>

0728A:

c) Negative * *delete as appropriate*

d) Positive/Negative/None * *delete as appropriate*

0728B:

c) Negative

d) Positive/Negative/None * *delete as appropriate*

0728C:

c) Negative

d) Positive/Negative/None * *delete as appropriate*

0728D:

c) Negative

d) Positive/Negative/None * *delete as appropriate*

Relevant Charging Methodology Objectives:

- 0728:
a) Negative
aa) No response
b) None
c) None
e) None
- 0728A:
a) Negative
aa) No response
b) None
c) None
e) None
- 0728B:
a) Negative
aa) No response
b) None
c) None
e) None
- 0728C:
a) Negative
aa) No response
b) None
c) None
e) None
- 0728D:
a) Negative
aa) No response
b) None
c) None
e) None

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

Summary of position 0728, A, B, C, D

We have some fundamental concerns with the principles underlying these modifications so our comments are applicable to them all hence we have not provided comments on them individually.

- 1) We understand the argument that offering a discount **may** be beneficial (and lawful for a company that is not a monopolist) but given the size of the discount proposed there appears to be no financial benefit to ineligible customers by implementing any of the modifications. At best non-eligible customers are neutral and therefore there is no benefit in implementing more complex arrangements that raise compliance issues. See below and the additional information section for further information.

- 2) That they allow different contractual arrangements (lower prices) for the same service for a small number of very large consumers, thereby raising discrimination concerns. See the additional information section for further information.
- 3) They are not cost reflective and therefore are negative with respect to relevant pricing objective (a) and hence are not compliant with licence condition A5. We provide further comments on this in our comments on the Relevant Pricing Objectives below.

Our key point about the financial impact is most easily looked at in terms of 0728D. This provides for a 90% reduction in transportation charges for consumers directly connected to the NTS that are within 5km of an entry terminal. If this is implemented NTS revenues will fall by £77M a year (as stated in the modification). If this is not implemented then NTS revenues will not fall but there is a risk that they will fall by £85.6M ($77/0.9$) if all the eligible consumers disconnect from the NTS. If all the consumers disconnect after one year then in cash terms the impact is the same as if the discount was given and they remained connected as $10 \times 77 = 9 \times 77/0.9$. We therefore do not see that implementing 0728D is beneficial to non-eligible customers as they will, at best, be broadly neutral on a revenue basis.

Given that all the modifications state that the revenue lost by NTS is in the range £55M (0728 and 0728A) to £77M (0728D) then we believe that the above challenges apply to all of 0728, A, B, C and D but we do not have the data to demonstrate this. At the very least various counterfactual scenarios should be modelled showing the effects on NTS revenues of various combinations of sites disconnecting at various times.

We provide more detailed analysis on this point in the additional information section and the attached Excel file. The additional information section also includes more detail on point (2) above.

There may well be compelling national or regional economic arguments for providing discounts to these large customers but unfortunately, they are neither stated in the modification proposals nor relevant to the objectives against which they have to be assessed. On the basis of the evidence presented it seems that both ineligible Users and those that could economically by-pass the NTS would be better off if the modifications were not implemented and large consumers progressed the option most beneficial to them.

Assessment against Relevant Objectives

Below is our assessment against the standard relevant objectives and also the charging relevant objectives that only apply when the modification applies to make changes to the charging arrangements.

Standard Relevant Objectives:

Relevant Objective (c) Efficient discharge of the Licensee's [Transporter's] obligations

All modifications are negative regarding furthering this relevant objective because we do not see that they further licence condition A5 that requires charges to be

cost reflective. The driver for this arrangement is clearly not cost reflexivity but rather a desire (that our analysis suggests is misguided) to avoid these consumers disconnecting in the belief that this will financially benefit NTS.

Relevant Objective (d) Securing of effective competition between relevant Shippers

There is no impact on this relevant objective for all modifications. We accept that keeping these customers connected to the NTS would allow them to participate in the regulated market for gas; however we assume that were they to disconnect from the NTS then these consumers would ensure that their new arrangements enabled them to competitively source gas to the extent they required.

Relevant Charging Objectives

Relevant Charging Objective a Save in so far as paragraphs (aa) or (d) apply, that compliance with the Charging Methodology results in charges which reflect the costs incurred by the licensee in its transportation business;

All modifications are negative regarding furthering this relevant objective because the charges are not cost reflective.

The justification in all the modifications is “The discussions under Request 0670R identified that it would be beneficial to have a product that helps manage potential inefficient bypass through the charging framework.”

No evidence is presented to support this argument and the further justification contains a list of claims about the proposal with again -no supporting evidence. This is no better than “proving” that something is true by asserting it as fact. In actual fact, as our example shows there is no evidence that these very large discounts deliver any value to non-eligible users of the NTS. The modifications calculate the discount based on answering the question “What discount will discourage a consumer from disconnecting from the NTS”. This demonstrates that the charges are not reflective of the costs incurred by the licensee in its transportation business and therefore clearly does not further the relevant objective. The question is in any case the wrong question to ask. The correct question to ask is twofold:

- 1) What is the maximum level of discount that ineligible customers would be willing to offer to discourage a consumer from disconnecting from the NTS?
- 2) Will this discourage a consumer from disconnecting?

There are differences between the modifications in that A and D include Non-Transmission Services costs as well as Transmission Services costs and D is justified by referring to users sharing costs of by-passing the NTS but they all suffer from the same basic flaw.

Relevant Charging Objective b) That, so far as is consistent with sub-paragraph (a), the Charging Methodology properly takes account of developments in the transportation business;

We do believe the relevant charging objective is relevant to these modifications, there have been no developments in the transportation business that provide a justification for this modification. These sites and the relevant entry terminals have been in existence for a number of years.

Relevant Charging Objective c) That, so far as is consistent with sub-paragraphs (a) and (b), compliance with the charging methodology facilitates effective competition between gas shippers and between gas suppliers

There are no competition benefits, most discussions about competition relating to pricing rely on the argument that the charges are most cost reflective. The proposed discounts are not cost reflective and hence we do not see how they further this relevant charging objective.

Relevant Charging Objective 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.

The justification put forward against this relevant objective is that the proposals are compliant with the EU Tariff Code but that is not the test. The test is about furthering the relevant objective, at best we suggest that the modifications are compliant but do not further compliance with the EU Tariff Code over and above the arrangements already approved under 0678A.

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

See our answer to Question 2 specifically asked in the consultation.

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

Implementing a modification that provides too large a discount will result in ineligible customer paying more than they otherwise would do. It may seem counter-intuitive that allowing customers to disconnect may be the best option for the ineligible customers but we believe that there is a significant risk of this due to a belief that it is essential to keep these large consumers connected to the NTS regardless of the discount offered.

WWU is therefore at risk of incurring higher Exit Capacity charges than it otherwise would pay if the wrong decision is made.

NTS have published their Exit Capacity charges from 1st October 2020 following the Authority's Direction to implement 0678A. These presumably assume that no optional charge arrangements are implemented. We assume that implementation of one of the 0728 Modifications will result in a price increase of around 5% to Exit Capacity charges soon afterwards based on the revenue impact in the modifications. This would impact WWU but we do not believe that this would, in itself, be large enough to require a mid-year price change to our transportation charges later in 2020/21.

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

We have not looked at the detail of the legal text as we believe that the basic principle behind the modifications is flawed.

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).

We have raised concerns previously in the 670R workgroup as to whether these modifications are compliant with NTS licence condition A5 that requires charges to reflect costs incurred by the Transporter. The driver for this arrangement is clearly not cost reflectivity but rather a desire (that our analysis suggests is misguided) to avoid these consumers disconnecting in the belief that this will financially benefit NTS. We have also raised issues regarding the discrimination issues. In our view the workgroup has largely ignored these concerns.

We have not considered compliance with Articles 28-32 of the Tariff Network Code.

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

We can understand the driver for those consumers that would benefit to get these arrangements in place by 1st October 2020. Solely from the point of view of NTS revenues, given that these consumers will take time to put in place by-pass arrangements there does not seem to be an immediate imperative to implement on 1st October 2020.

If the intent is to implement one of these modifications then there are clearly benefits in terms of continuity of charging arrangements from implementing on 1st October 2020. If this date is chosen then we expect consequential price adjustments will be required for NTS..

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.*

There is no analysis of the counterfactual, that is the impact of implementing none of the modifications and then consumers disconnecting from the NTS. The NPV of the revenue lost from implementation and not implementing under various scenarios should be modelled so that an informed decision can be made.

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

In this section have put in additional analysis and information on the points in the summary section.

There is no financial benefit to ineligible customers by implementing the modifications

We attach a spreadsheet that show that using a period to the end of GT3 price control and a 4% discount rate that not implementing 0728D and allowing these consumers to by-pass the NTS is financially the best strategy up to the end of GT3. For GT4 onwards the best strategy is to implement the 0728D but this seems a long time to wait for an uncertain benefit and assumes that all sites disconnect. We have not been able to model the other modifications as with these the discount varies with distance. The modelling assumptions can be varied but we believe that this simple work shows that more detailed modelling of the counter factuals is required. The information in the modification suggests that most of the impact of sites disconnecting is concentrated around a few east coast entry terminals principally Bacton and Teeside; however, it may be that, to provide a net benefit to ineligible NTS users, virtually all sites would need to disconnect. If so the likelihood and practical feasibility of this happening in a given time period needs to be assessed.

Lost revenue £millions							To end GT2	To end GT3	To end GT4
							NPV at 4% discount rate		
1) Assume modification implemented							£404	£675	£897
2a) Assume modification not implemented and all customers disconnect in 21/22							£366	£667	£915
2b) Assume modification not implemented and all customers disconnect in 22/23							£299	£612	£869
Lowest NPV of lost revenue							2b	2b	2b
Highest NPV of lost revenue							1	1	2a
							To end GT2	To end GT3	To end GT4
							Do not implement modification	Do not implement modification	Implement modification
Best strategy									

The proposed discount is offering a different contractual (lower price) arrangements for the same service.

The proposals all propose a substantially reduced price for consumers that are close to an entry point with no justification for this discrimination other than the incorrect, in our view, assertion that this is beneficial for other customers. Given that the NTS is a dominant provider of high pressure gas transportation services this raises competition issues.

Having different arrangements, such as an obligation to commit to remaining connected to the NTS for a period such as the length of a price control, would at least be a justification for a lower price although it would be difficult to argue that it justified reductions of up to 90%.

It is not clear whether a discount would be offered if these consumers disconnected from the NTS and connected to the electricity system (which may or may not be possible) The impact on the NTS in both cases is the same. The question whether this is beneficial is a matter for UK government energy policy. The logic that offering a discount protects NTS revenues would suggest that discounts would be offered to consumers that were thinking of switching fuels and this may lead to further discounts being offered to consumers that are not close to entry terminals. It is very difficult to justify the NTS offering discounts in this manner as it is a dominant provider of services and is subject to Competition law.