Representation – Modification UNC 0748 (Urgent)

Prospective Removal of Entry Capacity Revenue from Capacity Neutrality Arrangements

Responses invited by: 5pm on 11 December 2020

To: enquiries@gasgovernance.co.uk

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

Representative:	Julie Cox
Organisation:	Energy UK
Date of Representation:	11 December 2020
Support or oppose implementation?	Comments
Relevant Objective:	**c)** Comments **d)** Comments **g)** Negative
Relevant Charging Methodology Objective:	**a)** Comments **b)** Comments **c)** Comments

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

Energy UK is offering comments only, whilst it accepts that the revenue flows to entry capacity neutrality need to be addressed, we are concerned that this could lead to further unforeseen consequences due to the very rapid timescale proposed. This proposal was first published as a pre-mod late on 3 December before being issued for consultation on the 8 for 3 days, there have been no workgroups since the modification was raised, yet National Grid had over a month to develop its proposal. Therefore, it will not be possible for any market participants to fully assess the impact of the proposal.

Relevant Objectives:

c) Efficient discharge of the licensee's obligations.

A reference to which Special Condition NG refers to would be helpful here.

d) Securing of effective competition between relevant shippers

Transportation charges should not impact competition, particularly in a postage stamp regime.

This proposal seeks to reduce a charge that has already been published and factored into market prices. Any change up or down is a further change that will need to be factored in by the market. We consider that a smaller RRC value over a longer period of time would have less overall impact on the market.

It is not self-evident that Users will have greater confidence in forecasts of network charges, rather the opposite may be true as further change of unknown magnitude is anticipated. Such changes stem from the RIIO2 settlement, change to NG's forecasting approach for charges for future years and the ongoing risk of a proposal seeking retrospective change to the neutrality arrangements.

This issue has also highlighted the risk of further unintended consequences and raised significant questions about other parts of the charging regime with respect to compliance and cross-subsidy. For example, the exit capacity revenue flows to entry, given how the revenues from within-day firm and off-peak exit capacity flow into non – transmission services commodity charges which are paid by both entry and exit market participants.

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

Energy UK is very concerned that the UNC and TAR NC (Article 20) rules were not complied with in the calculation of the published RRC charges to address this neutrality issue and the general under-recovery position. UNC section Y3 requires RRC charges to be set for the remainder of the gas year, with Y 3.3.3a requiring a first notice setting out the reasons for the revision and an estimate of the RRC, before the formal notice of a change.

The RRC charges were set for a period significantly less than the remainder of the gas year, and applied differently for entry and exit RRCs and the non-transmission services commodity charge. There is no recognition that the UNC rules were being ignored or explanation as to why this is the case, beyond a desire for National Grid to recover revenue in the regulatory period. This significantly undermines the UNC contract between shippers / Users and National Grid and sets a worrying precedent for the future. TAR NC Article 20 also requires revenue reconciliation to take place in accordance with the reference price methodology, which is clearly defined in the UNC.

Implementation of this modification would appear to support further deviation from the UNC rules and TAR NC compliance by enabling a further adjustment to the already published entry RRC charge for a period less than the remainder of the gas year. We hope that Ofgem will direct for the RRC to be calculated in accordance with the UNC in its decision letter, and therefore apply over the remainder of the gas year which in itself will reduce the level of the charge and reduce the impact on the market and consumer prices.

Charging Relevant Objectives

a) charges reflect the costs incurred by the licensee in its transportation business

Ofgem's decision to implement UNC 0678 introducing a postage stamp regime, places less importance on cost reflectivity, so this is not really relevant.

b) properly takes account of developments in the transportation business

It is not entirely clear which developments in the transportation business are referred to here? The implementation of 0678A is not a development, rather the implementation of a change that hade been confirmed several months earlier. A shift to bookings that more closely match flows was an intended outcome of transmission charging reform, shippers were expected to make greater use of short- term products to do this.

Also, the capacity neutrality arrangements have been in place for many years so this is not a development.

c) facilitates effective competition between gas shippers and between gas suppliers

See relevant objective d above

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

It is clear that the compressed timescale presents challenges to all stakeholders. It is proposed that the FMR be submitted to Ofgem on Thursday 17 December. This is one day before Ofgem's Christmas moratorium usually starts. It is not clear how long Ofgem intends to take before issuing its decision but it should carefully consider the impact of issuing a decision during the moratorium period.

Many Shipper offices will be running a skeleton staff over that period, and whilst shipper operations are clearly 24/7 activities, regulatory staff may not be available, to receive and inform colleagues of the changes. Parties may therefore receive and react to Ofgem's decision in different timescales which could distort the market.

Ofgem needs to consider whether publications of market significance should be made during the moratorium. The market has already factored in the RRC charges with effect from February and whilst any change is likely to be downwards it is not appropriate to assume this will not further impact the market. A change is a change irrespective of direction.

Energy UK considers that a decision on this proposal should not be published during the moratorium period.

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

As trade association Energy UK faces no costs.

However, we note that Ofgem set an expectation of an assessment of impacts being included in the modification proposal[1]. The brief summary on page 9 hardly seems sufficient in this regard. Ofgem also asks in its urgency decision for impacts to be included in consultation responses. Participants will find this very challenging in a three-day consultation period.

We note that wholesale price impacts have been observed from February and into Q2 in 2021. We would expect these to be passed through to customers; for gas fired generation the costs will pass to the electricity market.

The impact on domestic customers is less direct, suppliers will be impacted by wholesale price impacts if their customers demand from February is not already fully hedged and they have sold fixed price contracts. The timescale and magnitude of changes to the DN ECN charges, is unclear and is also expected to be impacted by the RIIO2 settlement.

Security of supply may be impacted given the increased costs of storage withdrawal and injection, if the day on day price differentials do not support this cost, gas withdrawn after February may not be replaced leaving storage stocks depleted towards the end of the winter. Decisions on UNC 0727 and 0729 would be helpful in this regard.

There are also likely to be impacts on NG's constraint management incentive, Entry and Exit within day firm and interruptible / off-peak revenues contribute to this incentive[2]. Increased revenue flowing into this incentive pot is likely to be beneficial to incentive outcomes for National Grid. We expect Ofgem to follow up on this issue, to mitigate this impact, although we accept a licence change will be required, it should be considered in parallel with the UNC changes.

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

The legal text appears to deliver the intent of the proposal but its implementation would appear not be compliant with TAR NC.

The legal text allows any Transportation Charge to be amended within gas year 2020/21, but TAR NC Article 12 is clear that reference prices / reserve prices are binding for the gas year once published.

The definition of Transportation Charge includes reserve prices as well as RRC prices at entry and exit and therefore is far broader than applying only for an amendment to the entry RRC. It is not clear whether this wide-ranging ability to amend charges was NG's intention but it is not the expectation of the industry and needs to be addressed, we

[1] https://www.gasgovernance.co.uk/sites/default/files/ggf/202012/Minutes%20NTSCMF%201%20Dec%202020%20v1.0.pdf

[2] https://www.nationalgrid.com/uk/gas-transmission/document/123121/download

believe it would have been identified if there had been the opportunity for Workgroup consideration of the proposal and legal text.

Ofgem have requested that parties give due consideration to the following questions:

Q1: Do you agree that the treatment of interruptible and within day firm entry capacities feeding into capacity neutrality is inappropriate?

It would be easy to say yes to this question, but that would be an inappropriate simple response notwithstanding the magnitude of the revenue flows involved. There are many inter-related issues that have been highlighted as a result of the under-recovery situation, which need further consideration and are outlined below.

Please explain your rationale:

Q2: Do you agree that these revenues should be removed from capacity neutrality?

Energy UK agrees that a short-term solution is needed, but considers this issue raises wider questions as to whether the current framework is compliant with TAR NC and the roles of the TO and SO. We detail these concerns at the end of this response.

Please explain your rationale:

Q3: Do you support that National Grid should be a granted a one-off relaxation of its obligation to provide two months' notice of pricing changes?

Energy UK is concerned that this will lead to non-compliance with TAR NC as highlighted in the legal text section and could also support further deviation from UNC rules in Y section Y 3 and by association TAR NC article 20. We therefore have strong reservations about relaxing the obligation to provide two months' notice of changes to charges, especially to a period as short as 5 business days.

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

The premise of the modification is that revenues flowing into entry capacity neutrality and deviations of bookings from forecasted values were unforeseen. Capacity neutrality arrangements have been in place for almost 20 years and issues of where revenues flow for the various capacity products were raised during 0621 development.

It is also the case that bookings will always deviate from forecasts. Shippers booking short term products was anticipated in response the new charging arrangements being introduced, with the intent of bookings more closely matching flows. In this regard the regime is working as intended.

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

Energy UK has a number of additional concerns that have been highlighted by the under-recovery situation which gave rise to this modification proposal. Whilst these may go beyond the narrow scope of this proposal they are noted here since we believe they need further consideration, explanation and potentially resolution.

TAR NC compliance

TAR NC allocates transporter revenue into two categories of Transmission Services (TS) and Non-Transmission Services (Non-TS) revenues which are recovered via transmission services and non-transmission services charges. Industry was told at the time of 0678 development that these broadly match on to TO and SO activities. The under-recovery situation since 1 October has led us to explore the UNC and licence text in more detail. We have found that the drafting is so complex it is almost impossible to confidently identify which revenues are TS, non-TS and TO and SO. We have asked for a flow diagram to help us understand this in more detail, but this has not yet been provided.

We have also asked for clarification of the term at UNC Y 1.5.1 (d), which is subdivided into entry and exit terms in Y 1.5.2:

"*Allowed TS-Related NTS System Operation Revenue" is that amount of the Maximum NTS System Operation Revenue which is attributable (as determined by National Grid NTS) to charges in respect of NTS Capacity net of charges for the surrender of NTS Capacity;*

In particular the '*as determined by National Grid NTS*' part. This may correctly allocate certain capacity related revenues to being TS, but even if this is the case significant questions persist about cross subsidies, potential for double counting and consistency with the licence defined TO and SO.

Cross Subsidies

Whilst there is capacity neutrality at entry there is no parallel arrangement at exit, instead the revenue from within day firm and off-peak capacity sales pass to being a credit in the Non-TS commodity charge. This commodity charge is applied equally at entry and exit, therefore exit revenues are passing to entry. This would seem to be not compliant with TAR NC, in that TS revenue is allocated to Non-TS charges and it creates a cross subsidy.

Subject to clarification of the definition of the exit term in UNC Y 1.5.2 this revenue may also be counted as TS.

We consider that a further modification is required to address this cross subsidy, ensure entry and exit revenues are treated in a consistent manner and ensure compliance with TAR NC.

Role of SO

The issues above also question the definition of the roles and responsibilities of the SO, since activities, revenues and incentives should surely be aligned. Given the changes proposed above and further issues identified we are not convinced that this is the case and there is a risk of unintended consequences. We believe a more general review is required to ensure these are all aligned and the SO continues to be appropriately encouraged to release maximum capacity to the market.