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:	Richard Fairholme
Organisation:	Uniper
Date of Representation:	11 December 2020
Support or oppose implementation?	Comments only
Relevant Objective:	**c)** None **d)** None **g)** None
Relevant Charging Methodology Objective:	**a)** None **b)** None **c)** None

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

We are unable to determine whether this proposal better facilitates the UNC relevant objectives as there is inadequate information provided to properly assess this. The urgent nature of this proposal means there has been no real opportunity for industry to fully understand the impacts of the final proposal. Whilst we appreciate NGG's quick actions to identify the problem of unintended flows of revenue between the TO and SO "pots", resulting in significant RRC levels, we believe that this should have been foreseen much earlier by NGG. There was sufficient time between the 0678 Final Modification Report being sent to Ofgem (15 May 2019) and the 1 October 2020 implementation date, for NGG to properly assess the impact on capacity neutrality and progress any required changes. This is simply an oversight. Whilst the proposed solution helps mitigate the immediate impact of an extremely high RRC, it can only be considered a temporary "sticking plaster". A more fundamental industry review of capacity neutrality, incentives and TO/SO revenue streams must be undertaken regardless of whether this proposal is, or is not, implemented.

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

For market certainty and price stability, we do not believe it would be in anyone's best interests for Ofgem to make a decision on this proposal during the Christmas period, particularly if new or significant issues are raised during consultation. During this time, there is less market liquidity in general, so it will be harder for the market to digest and trade effectively in response to any announcements. A January Ofgem decision would be more acceptable.

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

Significant commercial impacts if (as proposed) <u>any</u> transportation charge is changed with just five days' notice.

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

No. The intent of the solution as we understand it is to address the high Transmission Services RRC, but the proposal and the legal text would allow NGG the ability to change '*any transportation charge due to NGG'* (Legal Text explanatory table) with just five business days' notice. As currently drafted, this would mean <u>any</u> capacity reserve price and both TS and Non-TS RRC levels at both Entry and Exit. This is not what most parties will have taken NGG's proposal to mean and, whether this is intended or not, the drafting needs to be tighter to prescribe a narrow, time-bound window in which this significant power can be used by NGG.

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?

And

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

It is not necessarily a question of whether it should be feeding into capacity neutrality at all, but rather whether the revenue should be assigned to TO or SO. Both within-day and interruptible capacity are created as by-products of long-term firm capacity being made available. As a result, both products relate more closely to the short-term, variable costs of operating a network (such as running compressors) rather than recovering the costs of long-term assets. In a simplistic model, where SO is about variable costs and TO about fixed costs, it would seem appropriate that revenues from these short-term products should be assigned to the SO. The introduction of a Postage Stamp model, which removed the concept of short and long-term marginal costs, has confused and undermined the existing licence structure of revenue streams. It appears to have resulted in undue cross subsidies between the TO and SO and therefore warrants urgent Ofgem attention, as this is not something that UNC parties can fix.

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?

No. This issue was foreseeable and NGG should have planned for it. It is unacceptable that all the risks (in terms of large unpredictable RRC) are passed directly through to network Users and customers when NGG makes forecast errors or fails to follow good practice. Under the current arrangements, NGG is exposed to almost no risk, whilst Shippers and the wholesale market bear it all. This direct pass-through of network charge volatility is clearly incompatible with a competitive and efficient wholesale gas market.

There must be a more equitable sharing of risk, which could take the form, for example of NGG absorbing some of the pricing volatility and spreading the cost recovery out over a longer period. Again, this would almost certainly require licence and/or incentive changes which only Ofgem can enact. Whilst we are not necessarily advocating such a solution, serious consideration needs to be given to options other than simply using the RRC.

In addition, a proposed reduction from two months to just five business days' notice for network Users sets an alarming and unacceptable precedent. Whilst on this occasion it is to reduce charges, the principle could equally be relied upon in future to raise charges at short notice. As noted above, the legal text also gives NGG the power to change any transportation charge with just business days' notice.

Overall, network Users need certainty about tariffs months in advance and also require predictability and stability. Changing tariffs at extremely short notice (up or down) doesn't respect the way that businesses operate and may lead to significant commercial losses. The normal minimum notice period of two months exists for good reason.

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.*

Inadequate or no analysis on impacted parties. If this proposal was not classed as urgent, a more thorough analysis could have been performed under the normal governance arrangements.

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