Energy UK

The voice of the energy industry

UNC Modification 0765 - New retrospective debit and credit charges to reflect changes to the treatment of Entry Capacity Revenue between October and December – Initial Representation

29 April 2021

Energy UK welcomes the opportunity to submit some initial comments for consideration by the workgroup. We have attempted to group the comments under headings to aid further consideration.

Governance and regulatory risk:

1. Changing the market rules after the event sets a bad precedent for the market, this modification may lead to further retrospective modifications in the future.

2. This proposal would increase regulatory risk and uncertainty and will affect future investment and may impact NBP liquidity, by having a detrimental impact on the credibility of the regulatory framework relative to other competing markets.

3. The market traded and settled during the period October – December 2020 on the prevailing rules, including those for the allocation of capacity neutrality revenue which had been in place for many years (almost 20 years). The allocation of revenues was not inappropriate.

4. The capacity neutrality revenue allocation rules were not affected by the implementation of UNC MOD 678A on 1 October 2020. The modification was approved with knowledge of the neutrality framework, although perhaps some oversight of its impacts. Oversight of existing rules or not fully understanding their impact is not a sufficient justification for a retrospective modification. Market participants have, in the past, tried to pursue retrospective changes, but Ofgem has rejected all of these.

5. The cash flows arose not only because of the neutrality arrangements but also through not adequately taking into account anticipated change in shipper behaviour in forecasts of FCC.

6. A change in shipper booking behaviour, to short term daily and within day products was expected, it was no surprise. It was discussed in workgroup meetings and included in consultation responses, but not considered in the FCC methodology. An expectation of bookings more closely matching flows was an intention and expected

outcome of the modification. Ofgem's final impact assessment makes this assumption in its analysis see para 1.24.

7. Industry flagged concerns about where revenues flow to during the development of UNC MOD 0621 which was a precursor to MOD 0678. This is mentioned in the FMR

   in sections 4.4 and 4.11 noting that interruptible revenue will flow to SO / non-transmission services revenue. Yet no cash flow modelling was carried out in the two years between the 0621 FMR and 0678 decision.

8. National Grid refers to Ofgem's Guidance on Code Modification urgency criteria, which includes commentary on observations on retrospective proposals. It says ' *It is a general principle that rules ought not to change the character of past transactions, completed on the basis of the then existing rules'* whilst recognising there could occasionally be circumstances which could require retrospective action. Ofgem considers that consideration will be on a case by case basis, but could arise due to the following:
   - a situation where the fault or error giving rise to additional costs or losses was directly attributable to central arrangements;
   - combinations of circumstances that could not have been reasonably foreseen; or
   - where the possibility of a retrospective action had been clearly flagged to the participants in advance, allowing the detail and process of the change to be finalised with retrospective effect.

   Materiality is also a factor

   Bullet points 1 & 2 are clearly not applicable here

   National Grid is relying on the third point, but the issues were not flagged in advance of 1 October 2020 rather at some point in November. The date referred to here is 5 November, but the minutes of that meeting make no reference to a proposal with retrospective action. National Grid should provide evidence on when it first suggested a retrospective change was being considered.

Market impacts:

1. The NBP price will reflect the price of the marginal source of gas production plus the costs of transporting gas to the NBP, as explained at 1.54 here. The RRC prices published by National Grid on 30 November 2020 here, moved the NBP price for February onwards when the market became aware if this publication. NBP prices moved again when further price changes were published on 30 December.

2. There will have been forward trades at the NBP during December which reflected the higher RRC charge which was then reduced at the end of the month.

3. There will have been forward trades for the period from February to September and daily trades which will reflect the RRC charge in the NBP price paid.

4. This modification makes no assessment of the NBP price impact, and makes no attempt to address these impacts, it simply moves money between shippers

5. The period to which the RRC charge applied will have finished before a decision is taken on this proposal.

Customer impacts:

1. Following the market impacts above customers will have been impacted by the RRC charge in a variety of ways depending on their supply contracts. Some will have direct passthru of wholesale gas prices, others may buy gas forward, whilst others may have fixed price contracts. The impact on customer welfare will be negative

2. These increased wholesale gas prices will be reflected in Ofgem's future price cap determinations for domestic customers. Until then suppliers / shippers will carry the cost impact.

3. The modification does not seek to address these impacts, the negative impact on customer welfare is not being addressed.

4. There will be no benefits to customers from this proposal

5. The prevailing gas price will have been, or will be, reflected in electricity prices

Shipper impacts and competition:

1. The proposal moves money between shippers, that had been correctly allocated according to the rules at the time, which were compliant with TAR NC, else 0678A would not have been approved. It is not clear what this is expected to achieve?

2. Competition and compliance is a live issue in a market, and reallocation of money does not impact past events. National Grid needs to provide a more detailed explanation as to how any revenue reallocation impacts the market, prices and is therefore beneficial for competition

Compliance:

1. The arrangements only partly address issues which have been identified as part of this process, including whether revenues from the sale of within day and interruptible exit capacity are transmission services or non-transmissions services and whether RRC charges are applied in a manner which avoids detrimental impacts of a dual regime as noted in the ACER report. These are all important from a compliance perspective

2. National Grid has identified daily firm and interruptible entry capacity as being transmission services on the basis of TAR NC compliance, it should explain why other capacity elements in the capacity neutrality calculation detailed in UNC B 2.13.2 are not part of transmission services.

Incentives:

1. National Grid's capacity constraint management incentives have been in place for many years, for details see here
   The revenues which flow into this incentive are:
   • Locational Energy sell actions and physical re-nomination incentive charges;
   • Short term and long term Non-Obligated Entry and Exit capacity (capacity released over and above the obligated level);
   • Interruptible Entry Capacity and Off Peak Exit Capacity;
   • Within Day Firm Entry and Exit Capacity sales; and
   • Entry overrun charges (the charges incurred when Users' flows exceed their capacity entitlements).

2. Whilst incentives are licence rather than UNC matters, the large volume of revenue flowing through the incentive will be positive under its incentive. NG will gain from this capacity neutrality 'incident' whilst customers have, and will continue to, pay higher gas and power prices.

3. A retrospective change to the RIIO 1 constraint management incentive needs to be progressing in parallel to this proposal.

Cash flows:

1. The cash flows arising from the capacity neutrality revenue allocation according to the prevailing rules have been estimated at £0.5M per day. National Grid needs to provide a much more detailed breakdown of this value across the period, including each of the elements above to better understand, what is considered part of this proposal and what isn't. NTS CMF outstanding actions 0107 and 0301 are also relevant here.

2. Shipper specific values for the clawback element should be determined and communicated to shippers so accounting provision can be made.

3. Modelling of RRC payments and potential refunds should be developed and updated with actual booking / payment information as the proposals is considered at the workgroup. February, March, April entry capacity bookings will be known by the first meeting on 4th May.

4. This information and clarity is also needed to understand if the RRC was set at the right level and where any under / over recovery appears in the future.

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