UNC Workgroup Report

At what stage is this document in the process?	
01	Modification
02	Workgroup Report
03	Draft Modification Report
04	Final Modification Report

UNC 0796:

Revision to the Determination of National Grid NTS Target Revenue for Transportation Charging

Purpose of Modification:

This Modification would revise the method of the determination of National Grid NTS Allowed Revenue for a Gas Year under the NTS Transportation Charging Methodology (TPD Section Y Part A-I). The purpose of this change is to achieve a greater degree of year-on-year stability in the pricing of Transmission Services Capacity.

Next Steps:

The Proposer recommends that this Modification should be:

- considered a material change and not subject to Self-Governance; and
- be assessed by a Workgroup.

This Modification will be presented by the Proposer to the Panel on 16 December 2021. The Panel will consider the Proposer's recommendation and determine the appropriate route.

Impacted Parties:

High: Shipper Users, National Grid NTS

Low:

None:

Impacted Codes:

None

Contents

Timetable

Modification timetable:	
Pre-Modification Discussed	07 December 2021
Date Modification Raised	08 December 2021
New Modification to be considered by Panel	16 December 2021
First Workgroup Meeting	11 January 2022
Workgroup Report to be presented to Panel	17 February 2022
Draft Modification Report issued for consultation	18 February 2022
Consultation Close-out for representations	11 March 2022
Final Modification Report available for Panel	14 March 2022
Modification Panel recommendation	17 March 2022

Any questions?

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1 Summary

What

In respect of the provision of Transmission Services to Users of the NTS, pursuant to the terms of its Licence National Grid NTS ('National Grid') is entitled to recover specified Allowed Revenue over the course of a Formula Year (April to the following March inclusive). As the tariff year under the UNC is over the course of a Gas Year (October to the following September inclusive), the consequential identification of the quantity of revenue to be collected over the course of a *Gas* Year, and the overall quantity of capacity expected to be allocated over that same period is utilised to determine Reference Prices for Transmission Services Capacity charges. These charges are therefore set at a level which is intended to recover National Grid NTS' Allowed Revenue for the provision of Transmission Services.

Why

The key aim of the changes proposed is to **reduce the level of year-on-year volatility in Capacity Reserve Price rates.**

The existing mechanism for determination of Allowed Revenue due to be collected over the course of the Gas Year (as set out in the NTS Transportation Charging Methodology) only takes into account the Allowed Revenue for the Formula Year which ends in the relevant Gas Year without taking account of the Allowed Revenue for the *following* Formula Year (the first half of which coincides with the latter half of the relevant Gas Year).

This has led to significant year-on-year changes in the Capacity Reference Prices (and therefore Reserve Prices) which is **detrimental to market confidence** and is specifically contrary to the aims of the new NTS Charging Methodology which was introduced from October 2020.

As the Formula Year Allowed Revenue value will change year-on-year, we have concluded that it is necessary for the calculation of Revenue to be collected over the course of a Gas Year to take account of the Formula Year revenues in *both* Formula Years that coincide with the relevant Gas Year. We believe that implementation of a change that delivers a **more stable Capacity Reference Price** year-on-year (compared with those derived under the existing mechanism), will increase market confidence relative to the current arrangements and therefore better facilitate the objectives of the Charging Methodology.

Revision of the derivation of Allowed Revenue for a Gas Year, as advocated by this Proposal, requires that there are no other triggers to change revenues that would pass from one year to the next. Therefore the existing Transmission Services Entry Rebate Charge can impact the benefits of this change hence we are of the view it is appropriate to remove this charge.

How

The solution proposed would:

- **revise the determination of the Transmission Services Allowed Revenue** for each Gas Year by taking into account the Allowed Revenue for both Formula Years that partially coincide with the Gas Year instead of only the *earlier* of such Formula Years (as under the existing methodology); and
- **remove the existing Transmission Services Entry Rebate Charge**.

The solution is expected to positively contribute to the reduction of volatility in the Transmission Services Capacity Reference Price between Gas Years and therefore increasing market confidence when compared with the existing arrangements.

2 Governance

Justification for Authority Direction

As the Proposal seeks to adjust the methodology for the determination of Allowed Revenue applicable for a Gas Year (which will consequently impact the level of charges Users pay for Transmission Services Capacity) the Proposer is of the view that there is sufficient materiality to require a decision from the Authority. The magnitude of this impact is as set out under the "Analysis" sub-heading in the "Why Change?" section.

Requested Next Steps

This Modification should:

- be considered a material change and not subject to Self-Governance; and
- be assessed by a Workgroup.

National Grid has highlighted its concerns regarding the predictability and stability of entry tariffs in particular in a number of meetings of the NTS Charging Methodology Forum culminating in the issue of an open letter to industry on 28 May 2021 which set out our belief that further change to the charging regime was essential and a commitment to work with stakeholders and Ofgem to achieve this. Ofgem's response to this letter dated 4 June 2021 expressed support for this action noting the need to avoid interventions in the charging regime that undermine market confidence. Ofgem also encouraged National Grid and stakeholders to "*progress…at pace…committing to an ambitious and realistic timetable for the completion of the necessary steps to effect change*".

This solution is complementary to the measures proposed in Modification Proposal 0790 "*Introduction of a Transmission Services Entry Flow Charge*" but can also operate in isolation in the event that the Authority directs that 0790 should *not* be implemented.

3 Why Change?

Determination of Allowed Revenue for the Gas Year

In respect of the provision of Transmission Services to Users of the NTS, pursuant to the terms of its Licence National Grid is entitled to recover specified Allowed Revenue over a Formula Year (01 April to the following 31 March inclusive).

Transportation Charges are currently set to recover Allowed Revenue over a Gas Year (01 October to the following 30 September inclusive) hence there is a requirement to determine an amount of revenue to be recovered over the course of a Gas Year from the two 'part' Formula Years that coincide with the relevant Gas Year. In this respect, UNC TPD Section Y Part A-I (The NTS Transportation Charging Methodology) currently sets out how Formula Year Allowed Revenue is used to derive an Allowed Revenue for each Gas Year. This is set out on section 1.6.1 of that Methodology which sets out that the Allowed Revenue for a Gas Year (AR_y) is determined as follows:

$$AR_y = (AR_t – R_{pt}) * F_{ry} * 2$$

where

AR_t *is the corresponding allowed revenue for Formula Year t;*

R_{pt} *is the amount of revenue (of the corresponding kind) which National Grid NTS estimates will be earned in respect of the part of Formula Year t which falls prior to Gas Year y;*

F_{ry} *is a factor which represents National Grid NTS's estimate of (A / B) where A is the amount of revenue (of the corresponding kind) which would be expected to be earned on average in any month in Gas Year y as a whole, and B is the amount of revenue (of the corresponding kind) which would be expected to be earned on average in any month in the part of Formula Year t which falls within Gas Year y.*

In the above formula:

- $\mathbf{AR_t - R_{pt}}$ determines the remaining Formula Year (FY) revenue to be collected over the second half of the FY (October to March inclusive) which coincides with the first half of the Gas Year (GY);
- a factor ($\mathbf{F_{ry}}$) is applied to this remaining revenue due for collection over six months, this factor being based on the average monthly revenue to be collected over the course of the GY (**A**) and the average monthly revenue to be collected over the second half of the coinciding FY (**B**).

  If FY revenue to be collected in the following FY *increases* (compared to the current FY), this factor will be *greater than* 1, whereas if FY revenue to be collected in the following FY *decreases* (compared to the current FY), this factor will be *less than* 1; and
- the resultant value is doubled (***2**) to 'inflate' the consequential 6-month value to an annual value.

The application of this existing mechanism to translate Allowed Revenue for a Formula Year to Allowed Revenue for a Gas Year has led to significant year-on-year changes in Capacity Reference Prices (and therefore Reserve Prices).

This is [in part] due to the above formula only taking account of the Allowed Revenue due to be collected in the Formula Year which *ends* in the relevant Gas Year without taking account of the Allowed Revenue for the following Formula Year (the first half of which coincides with the latter half of the relevant Gas Year). As the Formula Year Allowed Revenue value will change year-on-year we have concluded that it is necessary for the calculation of Revenue to be collected over the course of a Gas Year to take account of the Formula Year revenue in *both* Formula Years that coincide with the relevant Gas Year instead of the existing approach.

Material variations (swings) in the Capacity Reference Prices (and therefore Reserve Prices) year-on-year is detrimental to market confidence and is specifically contrary to the aims of the new NTS Charging Methodology which was introduced from October 2020. We believe that implementation of the proposed changes will deliver more stable Capacity Reference Prices (and therefore Reserve Prices), thereby increasing market confidence relative to the current arrangements and therefore better facilitate the objectives of the Charging Methodology.

National Grid recognises the adverse impacts on the market material swings in capacity pricing hence in May 2021 National Grid agreed[1] to defer £45m allowed revenue from Formula Year 2020/21 to Formula Year 2021/22 specifically to dampen volatility of Entry Capacity Reserve Prices. National Grid is of the firm view that this was a short-term fix and to repeat such for future years is not a sustainable solution to this issue.

Entry Rebate Charge

The current NTS Transportation Charging Methodology makes provision (in TPD Section Y Part A-I para 3.4) for the return of Entry Capacity Revenue to Users where revenue collected from Entry Points would exceed the Allowed Revenue at Entry Points (for a Formula Year) by at least £1m. In respect of timing, this charge, if triggered) is levied as soon as practicable after the end of a Formula Year (i.e. at some point following 01 April).

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[1] See https://www.nationalgrid.com/uk/gas-transmission/document/135741/download

We are proposing removal of this Charge as retaining it would undermine the methodology for derivation of Allowed Revenue for a Gas Year as advocated by this Proposal. If National Grid under-recovers against Allowed Revenue, recovery of the deficit is accounted for in tariffs set for the following Gas Year. The reverse applies to over-recovery i.e. tariffs for the following Gas Year are set lower than would be the case in absence of the prior over-recovery.

We are of the view that if National Grid over-recovers at Entry, then it should offset tariffs into the following Gas Year and not be returned mid-year via the existing Entry Rebate Charge. This is consistent with the aim of enhancing price stability and predictability[2] by limiting tariff rate changes (including the levy of new charges) to the commencement of the tariff period (i.e. commencement of the Gas Year).

It is worthy of note that the purpose of this charge it somewhat less relevant under the current commercial landscape as in recent years competitive auctions are not driving up the Entry Capacity payable price materially above the Reserve Price which has limited the effect of driving an over-recovery against Allowed Revenue. The rebate was primarily introduced as a mechanism to return excess revenue driven by pure market activity in auctions increasing the payable price. However, the current 'top down' approach where capacity reference prices are derived by dividing capacity into a target revenue thereby leaving less likelihood of significant driving up of prices from the Reserve Price to the payable via the auctions (as was assumed under the LRMC regime) makes it less relevant and applicable. Hence National Grid is of the view it is appropriate to remove this charge.

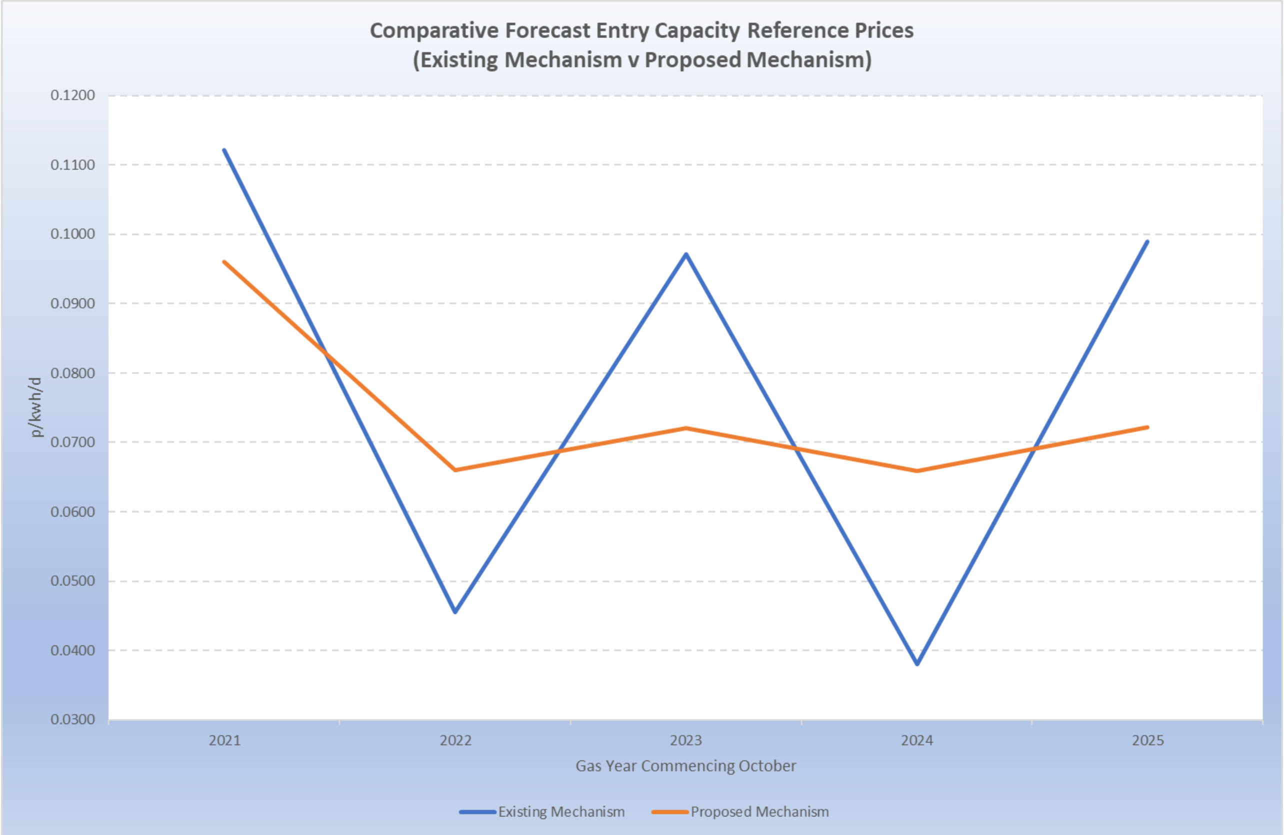
Analysis

The following table compares the forecast outcome (in terms of Entry Capacity Reference Price) of both the existing mechanism for determination of Allowed Revenue and the approach advocated by this Proposal. Note that in the analysis we have discounted the aforementioned deferral of Entry revenue agreed by National Grid in May 2021 (for October 2021 price setting) in order to demonstrate the impact of the change proposed in absence of any other specific interventions aimed at reducing price volatility.

Formula Year commencing	Entry Allowed Revenue for FY (£m)	Gas Year commencing	Existing Mechanism		Proposed Mechanism	
			Entry Allowed Revenue for GY (£m)	Entry Reference Price (p/kWh/d)	Entry Allowed Revenue for GY (£m)	Entry Reference Price (p/kWh/d)
Apr-21	560.1					
Apr-22	426.0	Oct-21	573.5	0.1122	502.3	0.0961
Apr-23	441.3	Oct-22	287.1	0.0455	396.3	0.0660
Apr-24	413.5	Oct-23	586.4	0.0972	449.6	0.0720
Apr-25	416.7	Oct-24	250.7	0.0380	397.5	0.0659
Apr-26	425.9	Oct-25	573.1	0.0989	430.5	0.0722
		Max Change (%)		160		31
		Average Change (%)		99		15

[2] See Ofgem's Open letter to National Grid dated 23 December 2020

The comparative extent of year-on-year Entry Capacity Reference Price volatility is illustrated in the following chart:



4 Code Specific Matters

Reference Documents

[UNC TPD Section Y] (including Part A-I: NTS Transportation Charging Methodology)

Knowledge/Skills

Knowledge of the current NTS Transportation Charging Methodology (in place from October 2020) would be beneficial.

5 Solution

It is proposed that NTS Entry Transmission Services Rebate Charge (the methodology for which is set out in TPD Section Y Part A-I 3.4 and the charging mechanism for which is set out in TPD B2.11) is removed.

It is proposed that existing method of determining Allowed Revenue for a Gas Year (AR_y) as set out in paragraph 1.6.1 of TPD Section Y Part A-I (The NTS Transportation Charging Methodology) is replaced by the following method. Whilst there is a subtle change to how Non-Transmission Services Revenues are worded to avoid confusion between terminology and to be less generic, the method is exactly the same as the current methodology and not impacted by this proposal.

1.6.1 For the purposes of this Part A-I, in relation to a Gas Year (y):

(a) "**Allowed Transmission Services Entry Revenue**" ($ATSEnR_y$) and "**Allowed Transmission Services Exit Revenue**" ($ATSExR_y$) shall be determined, on the basis of the Allowed FY Transmission Services Entry Revenue and the Allowed FY Transmission Services Entry Revenue respectively for the Formula Years which end and start in Gas Year y, as follows:

$$ATSEnR_y = (AFTSEnR_t – TSEnR_{pt}) + ((AFTSEnR_{t+1} * F_{TSEn})$$

$$ATSExR_y = (AFTSExR_t – TSExR_{pt}) + ((AFTSExR_{t+1} * F_{TSEx})$$

(b) "**Allowed Non-Transmission Services Revenue**" ($ANTSR_y$) shall be determined, on the basis of the Allowed FY Non-Transmission Services Revenue for the Formula Year which ends in Gas Year y, as follows:

$$ANTSR_y = (AFNTSR_t – NTSR_{pt}) * (1 / F_{NTS})$$

1.6.2 For the purposes of this paragraph 1.6:

(a) Formula Years t and t+1 are respectively the Formula Years which end and start in Gas Year y;

(b) $AFTSEnR_t$, $AFTSExR_t$, and $AFNTSR_t$ are respectively the Allowed FY Transmission Services Entry Revenue, Allowed FY Transmission Services Exit Revenue and Allowed FY Non-Transmission Services Revenue for Formula Year t;

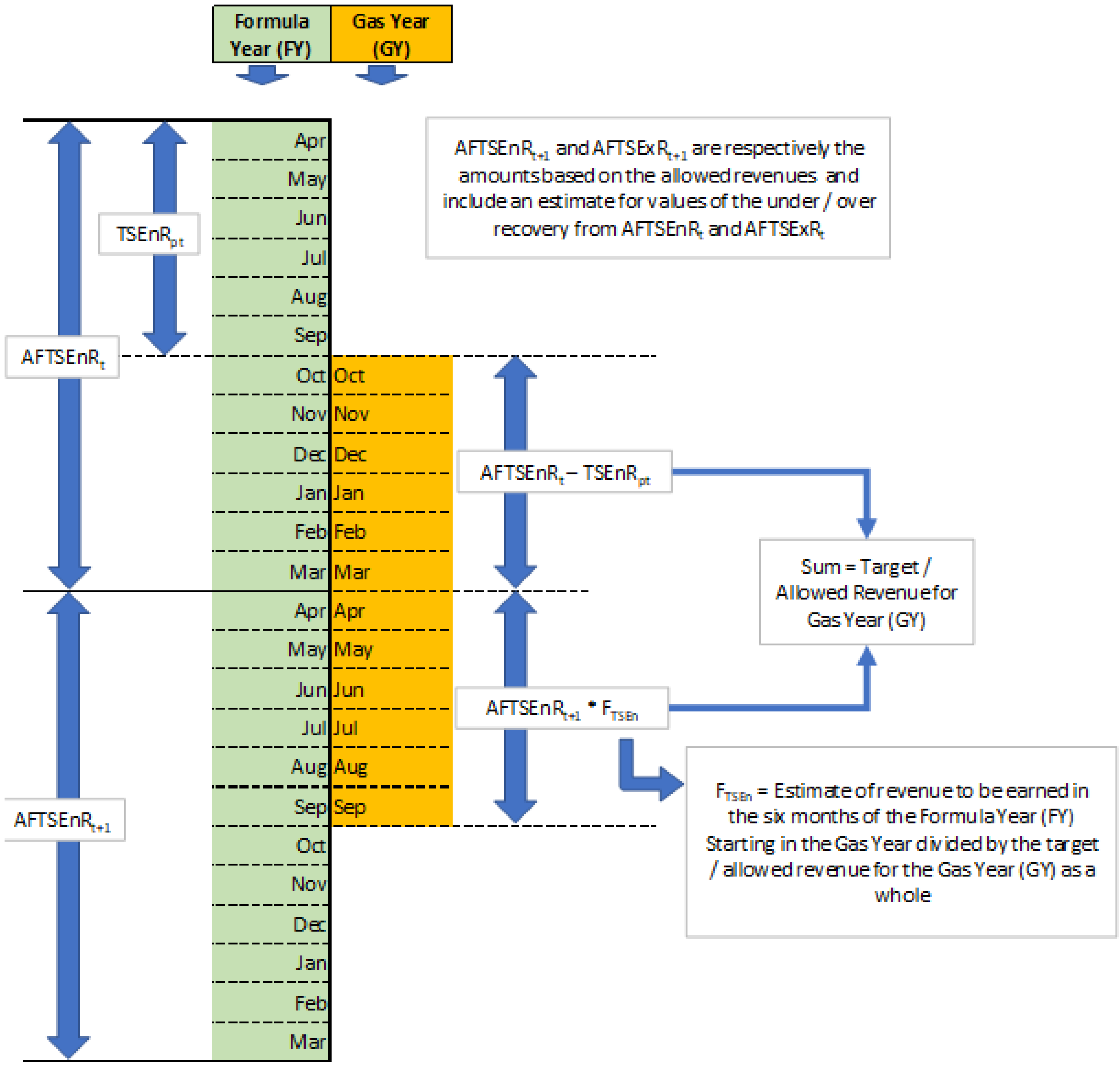
(c) $TSEnR_{pt}$, $TSExR_{pt}$ and $NTSR_t$ are respectively the amounts of Transmission Services Entry Revenue, Transmission Services Exit Revenue and Non-Transmission Services Revenue which National Grid NTS estimates will be earned in respect of the part of Formula Year t which falls prior to Gas Year y;

(d) $AFTSEnR_{t+1}$ and $AFTSExR_{t+1}$ are respectively the amounts estimated (on the basis of estimated values of the terms $K_{En,t}$ and $K_{Ex,t}$) by National Grid NTS as the Allowed FY Transmission Services Entry Revenue and Allowed FY Transmission Services Exit Revenue for Formula Year t+1;

(e) FTSEn and FTSEx respectively are factors which represent National Grid NTS's estimates, for Gas Year y, of the proportions of the Transmission Services Entry Revenue and of the Transmission Services Exit Revenue which will be earned in respect of the part of Formula Year t+1 which falls within Gas Year y.

(f) F_{NTS} is a factor which represents National Grid NTS's estimate, for Gas Year y, of the proportion of the Non-Transmission Services Revenue which will be earned in respect of the part of Formula Year t which falls within Gas Year y.

The following diagram illustrates the determination of the Allowed Revenue for the Gas Year for Transmission Services (same approach for Transmission Services Entry and Exit). The illustration shows the determination using Transmission Services Entry as the example and the same approach is applied for Transmission Services Exit



6 Impacts & Other Considerations

Does this Modification impact a Significant Code Review (SCR) or other significant industry change projects, if so, how?

None.

Workgroup Participants made no comment.

Consumer Impacts

There will potentially be an impact on different consumer groups but the Formula Year Allowed Revenue (determined in line with National Grid NTS' Licence) which is collected by National Grid NTS will not change in the event of implementation of this Proposal. This Proposal will essentially revise the determination of Allowed

Revenue to be collected over the course of a Gas Year in order to reduce the level of volatility in the Transmission Services Capacity price. National Grid NTS believes this change would deliver a methodology that is better aligned to the objectives of the NTS Transportation Charging Methodology than the current arrangements.

The nature of how the Users' Transportation charge liability is charged downstream from UNC arrangements will depend on how Users and other market participants structure their respective contracts and associated service charges.

Workgroup Participants made no comment.

What is the current consumer experience and what would the new consumer experience be?

The nature and extent of any change in consumer experience is not clear for the reason explained above.

Impact of the change on Consumer Benefit Areas:	
Area	Identified impact
Improved safety and reliability No impact.	None
Lower bills than would otherwise be the case Individual consumers bills may change as a consequence of implementation dependent upon how the associated transportation costs are recovered from downstream stakeholders under the relevant contractual terms.	Potentially impacted.
Reduced environmental damage No impact.	None
Improved quality of service No impact.	None
Benefits for society as a whole No impact.	None

Cross-Code Impacts

No impact.

EU Code Impacts

No impact.

Workgroup Participants made no comment.

Central Systems Impacts

No impacts. The implications are limited to the charges setting processes which to a large extent utilises 'non-central' systems.

Workgroup Participants made no comment.

Performance Assurance Considerations

A Workgroup Participant commented that there would be no impact.

Workgroup Impact Assessment

Workgroup Participants did not make any further comment on the impact assessments identified in the proposal.

Some Workgroup Participant felt that there would be a better method for determining the revenue target component associated with the second half of the relevant gas year.

A Workgroup Participant advocated that it could be based upon a revenue proportion for the Formula Year starting in the relevant Gas Year rather than one based on the Gas Year.

The proposer countered the approach mentioned as the inherent approach to pricing is centred on a Gas Year and this has been maintained. By linking strictly to a Formula Year as was mentioned, it would mean calculating pricing for a Formula Year to achieve the result, and Formula Year prices do not exist in the tariff methodology and goes against the requirement to price for a Gas Year and also presents issues in replicability and transparency.

The same Workgroup Participant noted that the approach to the adjustment for K ending in the Formula Year ending within the Gas Year is likely to mitigate the price smoothing that is the objective of the Modification by placing an undue weight on Formula Year revenue recovery ending within the Gas Year.

A Workgroup Participant believed that this modification should be implemented but does not agree that it is complimentary to Modification 0790 as stated in the justification for Modification 0796. This Modification 0796 should be implemented, and the impact assessed with at least 1 year of data prior to implementing Modification 0790.

7 Relevant Objectives

Impact of the Modification on the Transporters' Relevant Objectives:

Relevant Objective	Identified impact
a) Efficient and economic operation of the pipe-line system.	None
b) Coordinated, efficient and economic operation of (i) the combined pipe-line system, and/ or (ii) the pipe-line system of one or more other relevant gas transporters.	None
c) Efficient discharge of the licensee's obligations.	None
d) Securing of effective competition: (i) between relevant shippers; (ii) between relevant suppliers; and/or (iii) between DN operators (who have entered into transportation arrangements with other relevant gas transporters) and relevant shippers.	Positive
e) Provision of reasonable economic incentives for relevant suppliers to secure that the domestic customer supply security standards… are satisfied as respects the availability of gas to their domestic customers.	None
f) Promotion of efficiency in the implementation and administration of the Code.	None
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.	None

Demonstration of how the standard Relevant Objectives are furthered:

d) Securing of effective competition between relevant shippers;

The proposed changes in this Modification are expected to provide a more stable and predictable Reference Price (and therefore a more stable and predictable Reserve Price) for Capacity, compared to the status quo hence Users will have a greater level of confidence in their forecasts of prospective use of network costs and therefore set their own service costs more accurately (potentially with a lower risk margin), thereby enhancing effective competition.

Workgroup Participants made no further comments.

Impact of the Modification on the Transporters' Relevant Charging Methodology Objectives:

Relevant Objective	Identified impact
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;	None
aa) That, in so far as prices in respect of transportation arrangements are established by auction, either: (i) no reserve price is applied, or (ii) that reserve price is set at a level - (I) best calculated to promote efficiency and avoid undue preference in the supply of transportation services; and (II) best calculated to promote competition between gas suppliers and between gas shippers;	Positive
b) That, so far as is consistent with sub-paragraph (a), the charging methodology properly takes account of developments in the transportation business;	None
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; and	Positive
d) That the charging methodology reflects any alternative arrangements put in place in accordance with a determination made by the Secretary of State under paragraph 2A(a) of Standard Special Condition A27 (Disposal of Assets).	None
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.	None

Demonstration of how the charging Relevant Objectives are furthered:

aa) That, in so far as prices in respect of transportation arrangements are established by auction (ii) that reserve price is set at a level - best calculated to promote competition between gas suppliers and between gas shippers;

The proposed changes in this Modification are expected to provide a more stable and predictable Reference Price (and therefore a more stable and predictable Reserve Price) for Capacity.

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

The proposed changes in this Modification are expected to provide a more stable and predictable Reference Price (and therefore a more stable and predictable Reserve Price) for Capacity hence Users will have a greater level of confidence in their forecasts of prospective use of network costs and therefore set their own service costs more accurately (potentially with a lower risk margin), thereby enhancing effective competition.

Workgroup Participants made no further comments.

8 Implementation

Implementation of this Proposal should take effect in time to be reflected in the Transportation Charges which will apply from 01 October 2022 or the next 01 October following the Authority direction to implement. Reserve Prices need to be published by the end of May (ahead of the commencement of the Gas Year) hence a decision would be required before the end of May to facilitate implementation in the following October.

Workgroup Participants made no comment.

9 Legal Text

Text Commentary

Legal Text Commentary is published alongside this Modification report here: https://www.gasgovernance.co.uk/0796

Text

Legal Text is published alongside this Modification report.

Workgroup Participants noted that the legal drafting appears to deliver on the intent.

10 Recommendations

Workgroup's Recommendation to Panel

The Workgroup asks Panel to agree that:

- This proposal should proceed to consultation.