

**Representation - Draft Modification Report UNC 0823**

**Amendment to the Allocation of Entry Capacity and Flow Quantities to Qualifying CNCCD Routes**

**Responses invited by: 5pm on 17 January 2023**

To: [enquiries@gasgovernance.co.uk](mailto:enquiries@gasgovernance.co.uk)

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

<b>Representative:</b>	Lauren Jauss
<b>Organisation:</b>	RWE Supply & Trading GmbH
<b>Date of Representation:</b>	17 January 2023
<b>Support or oppose implementation?</b>	Support
<b>Relevant Objective:</b>	a) Positive d) Positive
<b>Relevant Charging Methodology Objective:</b>	<b>Not applicable</b>

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

RWE is the proposer of this modification. The current arrangements mean that customers and Shippers who operate CNCCD (or “short haul”) routes that share an Entry Point (“multi routes”) do not receive the same level of discount on each route as Shippers who operate identical single routes. This is because even where a Shipper has bought sufficient Entry Capacity to accommodate their Entry Allocation at the shared Entry Point (and does not Overrun) the current apportionment calculation, which is only undertaken for multi-routes, apportions capacity and flow differently to each route for the purposes of calculating the short haul discount eligibility. This means that one route can appear to have insufficient Entry Capacity procured to accommodate the gas flow and is not eligible for a full discount.

We believe that this is discriminatory and unnecessarily reduces the competitiveness of customers, Suppliers and Shippers who operate multi-routes.

The proposed change to the calculation of Entry Capacity and Entry Allocation apportionment would resolve this issue.

**Customers are primarily impacted by the defect that this proposal addresses**

It is the customer that has the option to build a pipeline to bypass the NTS and contract directly with producers or importers without needing to engage with a Shipper. UNC728

was the urgent modification that was implemented in 2021 and granted the short haul discount on qualifying capacity holdings to avoid inefficient bypass. Large customers are usually fully aware of the short haul arrangements and any Shipper aiming to win their business can expect to fully pass through the short haul discount. Hence, it is the customer that is at a disadvantage if they cannot access those arrangements.

The current arrangements mean the operations of one customer can reduce the discount of another customer. This means that if a customer is associated with a single short haul route, but their Shipper and Supplier take on an additional customer, the first customer could be unexpectedly impacted with capacity costs much higher than they anticipated or planned for. The customer's competitiveness is reduced in this scenario.

When a customer's supply contract is due for renewal, if they are aware that a Supplier and Shipper are already associated with another short haul route with which they would share an Entry point, the customer is more likely to choose an alternative Supplier and Shipper. This scenario would put Suppliers and Shippers already operating a nearby short haul route at a competitive disadvantage.

### **Annual capacity charges are higher for customers that are part of a multi-route than those with identical single routes**

Of the five different proposals in UNC728, there were four different discount levels. Ofgem selected the one that they believed was an appropriate discount level to avoid inefficient bypass. We do not think that this level is particularly generous. We give reasons for this view further below.

However, the overarching objective of this proposal is to achieve equal and non-discriminatory conditions so that multi-route customers can receive the same discount as other single route customers. It is not to re-open the debate as to whether the level of the discount that Ofgem selected is appropriate. We do not believe that the current multi-route arrangements are consistent with the principles of non-discrimination in the Gas Act and Transmission Licence.

### **This effect was overlooked at the time of UNC728**

UNC728 was an urgent modification that was preceded by a several pre-modification discussion meetings, but the proposal itself was developed along an urgent timeline. We do not think there was sufficient time to fully consider the detail regarding this change and believe that most if not all of the proposers and those that responded to the consultation were unaware of this multi-route effect. None of the examples presented in connection with UNC728 and in the Final Modification Report illustrate this issue. For this reason, we believe this multi-route problem which results in a potential mismatch of Entry Capacity and flows was overlooked and the impact was unintended. This proposal seeks to amend this oversight.

### **The short haul arrangements are not competitive with a bypass pipeline in the current environment, so the multi-route mismatch of capacity and flow makes bypass risk higher**

The conditions to qualify for the short haul discount are designed to closely match the scenario and compete with the cost of Users alternatively building their own pipeline to bypass the NTS. However, the requirement to flow gas along the route to qualify for a

discount on capacity holdings means that short haul arrangements are currently not particularly effective in mirroring the ownership of a pipeline. Ownership provides a cost effective option (but not obligation) to flow gas. However, short haul route Users must pay full price on unused capacity.

To date, we think the short haul arrangements have worked relatively well because intermittent Users have historically been able to purchase capacity gas day ahead, to closely match their customers' daily flow requirements. However, Users now have concerns about access to Exit Capacity day ahead, and many have made purchases in annual auctions to cover their customers maximum daily requirements and mitigate this risk. Hence, the short haul arrangements are not competitive with a bypass pipeline, particularly in the current environment.

In order to better represent the cost benefit of owning a pipeline, RWE proposed the alternative UNC728C. This differed from the Original only in that it did not require a User flow gas to be eligible for the discount. However, it was rejected by Ofgem, and as we understand it, this was primarily because the level of the proposed discount was too large in both the Original UNC728 and our alternative. UNC728B was approved instead.

We think that even with the discount, some customers may still be considering bypass now that they have tried the short haul arrangements for several years. We think it is likely that Ofgem did not make any allowance for a proportion of unused and therefore undiscounted capacity. If that's the case, where some capacity is unused, charges are likely to be more expensive than anticipated, and the short haul discount is likely to be less effective than Ofgem intended. Consumers are now investing in assets for the energy transition, and may be considering pipeline investments that could provide future options and benefits. This may provide more practical opportunities to consider bypass pipelines. Investors may also use the current short haul arrangements as an indication of the cost and terms of future shared use of other networks in their cost benefit analyses, to decide whether to invest in a dedicated customer-owned pipeline.

The cost impact of unused Exit Capacity on customers that are part of a short haul multi-route is particularly material, because it reduces the discount on Entry capacity which is much more expensive than Exit and it reduces their competitiveness. The resulting discount level is therefore lower still and much lower than for other customers with a single route.

**Self-Governance Statement:** *Please provide your views on the self-governance statement.*

We believe this proposal meets the self-governance criteria.

We believe that National Grid's approach of using known long term bookings and historical flows is a good way of estimating the materiality of this modification. We agree with their calculations that this modification would have an £1.62m impact on capacity charges for Gas Year 2022/23 (assuming the probability of bypass is unaffected). This strongly indicates that this modification is below the materiality threshold of £5m.

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

We note that National Grid has confirmed that the low materiality of this modification would not affect the result of the calculation of capacity reserve prices. Given the lead

time required for system changes, we believe an appropriate and achievable implementation date is October 2023.

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

None

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

Yes

**Modification Panel Members have requested that the following questions are addressed:**

*Q1: Does this Modification meet the Self Governance criteria?*

Yes, we believe this modification clearly meets the self-governance criteria because we do not believe that £1.62m is material enough to require Authority direction.

We note that the Self-Governance Criteria specifies that Proposers are required to demonstrate the materiality of their modification if they believe Authority direction is required. However, in practice we have observed that Proposers are required to demonstrate that modifications are not material in order to follow a Self-Governance route.

*Q2: Do you have any views regarding risk of bypass?*

Should this proposal be referred to Ofgem for a decision, RWE will be submitting evidence of the risk of bypass for consideration in their decision.

RWE have used specific knowledge and data to estimate the payback period for a bypass pipeline. The speed of the return depends on NTS capacity charges, pipeline build cost and capacity, degree of utilisation and how closely NTS capacity procurement matches flows amongst other things. We estimate that the discount level selected by Ofgem in UNC728B increases the payback period for a typical pipeline from a minimum of around 3 months, but still could be as little as only 3 years.

However, if we assume that half of the exit capacity that is procured is unused and ineligible for a discount (but Entry Capacity is bought closer to delivery and matches requirements), then the payback period could be reduced from a minimum of 3 years to about as little as only 1 year. We think this discount level is inefficient and is likely to lead to an increase in the frequency of NTS bypass pipelines in the medium term. Customers need to consider the lead time to build their pipeline and whether they can better match their capacity procurement to flows in the coming years.

Now consider the scenario of a Shipper operating two short haul routes with equal offtake capacity having a shared Entry Point to form a multi-route, and half of the Exit Capacity that is procured is unused (i.e., one site always flows gas to the maximum capacity whilst the other has no flow). In this scenario, the payback period for a bypass pipeline falls

from the minimum of about 1 year and in some scenarios could become less than 6 months.

We therefore think that the risk of bypass under current arrangements is much higher for multi-routes compared with single routes, because capacity costs for multi-routes can be double that of identical routes operated by a single Shipper, and the payback is half as long. A pipeline payback period of 6 months would mean that the annual capacity charges the multi-route User is contributing for only one route is currently much greater than the £1.62m estimated cost of all routes becoming eligible for a discount to which other Users are already entitled. We think the risk of the loss of this contribution is greater than the impact of implementation of these arrangements.

*Q3: Do you have views regarding the analysis provided in the DMR?*

As described above, we agree with National Grid's forecast of £1.62m being the impact this modification proposal would have had on this Gas Year 2022/23.

*(Confidential responses to be sent directly to Ofgem)*

**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.*

No

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

Additional evidence and analysis will be provided to Ofgem if this modification is referred to them for approval.