

### Representation - Draft Modification Report

**UNC 0678; 0678A; 0678B; 0678C; 0678D; 0678E; 0678F; 0678G; 0678H; 0678I; 0678J;**

### Amendments to Gas Transmission Charging Regime

0678	Amendments to Gas Transmission Charging Regime
0678A	Amendments to Gas Transmission Charging Regime (Postage Stamp)
0678B	Amendments to Gas Transmission Charging Regime
0678C	Amendments to Gas Transmission Charging Regime (Postage Stamp)
0678D	Amendments to Gas Transmission Charging Regime including a Cost based Optional Capacity Charge
0678E	Amendments to Gas Transmission Charging Regime – Treatment of Storage
0678F	Amendments to Gas Transmission Charging Regime – Treatment of Unprotected Entry Capacity Storage
0678G	Amendments to Gas Transmission Charging Regime including a Cost based Optional Capacity Charge
0678H	Amendments to Gas Transmission Charging Regime (Postage Stamp) including a Cost based Optional Capacity Charge
0678I	Amendments to Gas Transmission Charging Regime including Wheeling and an Ireland Security Discount
0678J	Amendments to Gas Charging Regime (Postage Stamp) including a Cost Based Optional Capacity Charge

**Responses invited by: 5pm on 08 May 2019**

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

<b>Representative:</b>	Julie Cox	
<b>Organisation:</b>	Energy UK	
<b>Date of Representation:</b>	8 May 2019	
<b>Support or oppose implementation?</b> (Please note you will be asked for your reasoning further below)	0678	Comments
	0678A	Comments
	0678B	Comments
	0678C	Comments
	0678D	Comments
	0678E	Comments
	0678F	Comments
	0678G	Comments
	0678H	Comments
	0678I	Comments
	0678J	Comments
	<b>Expression of Preference</b> (Please note you will be asked for your reasoning further below)	<p>Energy UK Members have a broad range of views on the various aspects of these proposals and a number of Members have raised proposals. It is therefore not possible to express a preference for a particular proposal. This response will therefore focus on general themes and some of the key issues Ofgem will need to consider in arriving at its position.</p> <p>We consider that Ofgem should undertake a Regulatory Impact Assessment, as these proposals have various distributional impacts it will be important to assess the impact on consumers and consider a number of trade-offs between various compliance and regulatory issues. We call on Ofgem to be explicit and transparent in how these trade-offs are made. We note the recent report from the National Audit Office<sup>1</sup> and the extract below</p> <p><i>Faced with these challenges and differing views over their effectiveness, it is vital that regulators measure and report transparently their intentions and achievements in meeting their duties towards consumers. This means they need to ensure that they:</i></p> <ul style="list-style-type: none"> <li>• <i>set out clearly their intended consumer outcomes, how they have dealt with competing incentives such as those of consumers and industry stakeholders, and any barriers or constraints they face in delivering their outcomes;</i></li> <li>• <i>examine whether they are achieving their intended outcomes and take corrective action where necessary; and</i></li> <li>• <i>demonstrate credibly to Parliament and other stakeholders how well they are discharging their duties and addressing the key issues for consumers.</i></li> </ul> <p>This seems very relevant in respect of the 0678 suite of proposals</p>

<sup>1</sup> <https://www.nao.org.uk/report/regulating-to-protect-consumers-utilities-communications-and-financial-services-markets/>

**Standard Relevant Objective:**

Energy UK considers that the workgroup report provides a comprehensive summary of the impact on the relevant objectives of each of the proposals. We will not replay those comments here rather try to cover the key points that Ofgem will need to consider.

**Standard Relevant Objective (continued):**

- a) The discussion in the workgroup report focusses on how locational prices may affect operation of the system, the role of an optional tariff avoiding inefficient bypass and the magnitude of the storage discount impacting operation of the system. Ofgem will need to consider the importance of this relevant objective compared to others and assess these issues in the context of impact on consumers.

Is operation of the system impacted by locational signals, potential for bypass of the system and the magnitude of storage discounts? To what extent are consumers impacted by these issues?

- b) Again, there are references to locational prices. Ofgem will need to consider the relevance of locational prices to this relevant objective and whether the locational prices established by the proposals are appropriate to have an impact on this objective. Do the locational prices send the correct signals?
- c) The need to avoid undue preference is the most relevant here. Ofgem will need to consider whether the treatment of existing contracts and the price disparity that arises is consistent with avoiding undue preference and whether the ability to profile new bookings within a quarter is sufficient to offset this.

We refer to this extract from Ofgem's GTCR policy view from November 2015<sup>2</sup>

**Our view is that floating capacity charges should apply to all contracts from the date of implementation, including those taken out under the current regime. We consider this would avoid market distortions between users buying the same entry point capacity for the same period but paying different charges depending upon the date they entered into the obligation to pay.**

This clearly acknowledges that distortions are created.

We also note SSE's QC legal advice which states it would be illegal not to apply a Revenue Recovery Charge to Existing Contracts.

We provide further comment in response to Ofgem question (1).

- d) Energy UK considers this to be one of the most important relevant objectives, whilst noting that transmission charges should be benign with regards to competition. This is best achieved by transmission charges being cost reflective. It is not self evident that either the CWD methodology nor the PS methodology establish charges that are cost reflective. The CWD methodology uses the cost drivers of capacity and distance but creates high exit charges at points close to entry points which seems to not reflect the cost of transporting gas over a short distance. Nor is the PS methodology cost reflective as it applies the same price

**Standard Relevant Objective (continued):**

at all points. So cost reflectivity cannot really be used to determine whether CWD or PS is most appropriate. Ofgem will need to consider other factors that impact competition such as price predictability and stability, and the impact entry prices will have on the wholesale price at the NBP as this impacts customer welfare.

The Frontier Economics study shared by Energy UK for UNC modification proposal 0621 demonstrated that a uniform charge is less likely to distort competition, as the same charge is paid<sup>3</sup>.

Other factors include the treatment of Existing Contracts considered in response to Ofgem question (1) and the FCC methodology.

The FCC methodology was produced very late in the workgroup process, yet it is key for the determination of prices. Some proposals include the methodology in the UNC to provide a governance framework that is understood for managing future change. The vast majority of Energy UK members support the methodology being included in the UNC or for there to be better defined governance of it, which may include including it within the UNC at a later date.

Energy UK submitted a number of observations on the FCC methodology and data, which have not adequately been addressed (see Appendix 1). This leaves significant uncertainty in the determination of FCC values in the future and could impact competition.

g) Energy UK considers that all proposals are more compliant than the current arrangements. Although whether proposals are fully compliant with all aspects of TAR NC in conjunction with CAM needs further consideration, there is considerable scope for interpretation in some aspects of TAR NC. Avoiding detriment to the GB gas market or customer welfare will an important issue for Ofgem to explore in its regulatory impact assessment.

Ofgem may also wish to review the proposals in other Members States, ACER's comments and the Member State's response.

For further comments see response to Ofgem question (5)

<sup>3</sup> <https://gasgov-mst-files.s3.eu-west-1.amazonaws.com/s3fs-public/ggf/book/2018-06/Representation%20-%20Energy%20UK%200621.pdf>

**Charging  
Methodology  
Relevant Objective:**

a) See comments against standard relevant objective (d) with respect to cost reflectivity. Energy UK does not consider cost reflectivity to be a key driver in determining the choice of reference price methodology, or a particular proposal. With an appropriate optional charge, the points using that charge could be said to have more cost reflective arrangements than other points.

aa) An issue here is the setting of multipliers to 1 which removes the differentiation between long term and short-term purchases, something that Ofgem had previously been opposed to, in the GCM 19 decision<sup>4</sup>.

Reflecting the fact that the SRMC of daily entry capacity is relatively low, Ofgem considers it appropriate that the reserve price for such capacity is lower than the reserve price for longer term capacity i.e. the Long Run Marginal Cost (LRMC). GCM19 would move further away from this position by basing the daily entry capacity auction reserve prices on the LRMC. We consider that the setting of artificial barriers such as a floor price which was higher than the SRMC would have an adverse impact on competition. Ofgem therefore does not agree that the current arrangements give undue preference to those booking capacity in the short-term.

However, we note that all proposals include this provision

Other issues in this regard relate to the retention of locational prices or a postage stamp approach, Energy UK members' view are divided on this issue. Ofgem will need to consider which approach overall best protects customer interests.

c) See comments against standard relevant objective (d)

e) See comments against standard relevant objective (d)

<sup>4</sup> [https://www.ofgem.gov.uk/sites/default/files/docs/2010/08/gcm019\\_decision\\_signed\\_0.pdf](https://www.ofgem.gov.uk/sites/default/files/docs/2010/08/gcm019_decision_signed_0.pdf)

**Implementation:** *What lead-time do you wish to see prior to implementation and why? Please specify which Modification if you are highlighting any issues.*

Energy UK members agree that the effective date if any of the proposals is implemented should be 1<sup>st</sup> October. This is supported by SSE's QC legal advice.

Adequate notice between any decision to the effective date should be provided to ensure the notification timescales are not shortened. Consideration should also be given to the storage year which starts on 1 May as well as the gas capacity year from October.

Consideration should also be given to how K factors and the start of the RIIO T2 period may affect charges so that significant step changes which are subsequently reversed can be avoided.

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

As a trade association - none

**Legal Text:** *Are you satisfied that the Legal Text will deliver the intent of the Solutions for each Modification? Please specify which Modification if you are highlighting any issues.*

Energy UK has not reviewed the detailed legal text for all proposals, however comments were provided during the workgroup process, these are included here where they do not seem to have been addressed. With respect to the legal text for 0678 and where these clauses are present for other proposals

Annex B 2.1.3 (d) says to scale but does not detail how

Annex B 2.4 says the reference price is a daily price but the mod on page 16 says it is an annual price, there is some inconsistency in parts of the mod proposals about the use of reserve price and reference price.

Annex B 1.6 introduces a formula for profiling factors that goes beyond the description provided in the proposals

Annex B 1.6 the term  $F_{ry}$  seems to be a monthly term with no aggregation for the number of months

Annex B 2.4.4 provides detail of how scaling factors are determined beyond what is included in the proposals

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

Energy UK would like to make the following observations regarding the 0678 development process. The original 0678 proposal raised by National Grid was granted urgent status on 25 January but with a defined series of workgroup meetings, this is highly unusual. The first meeting took place at short notice on 29 January. This was an intense schedule to achieve the deadline set for the issue of the workgroup report to consultation on 8 March.

The schedule did not anticipate numerous alternative proposals being raised; additional workgroup meetings were added to try to ensure that the deadline for completing the workgroup report was achieved. At this time there was very little time between meetings for stakeholders, including National Grid to undertake analysis or refine proposals.

Ofgem issued a letter extending the timetable on 8<sup>th</sup> March, providing for a hiatus in meetings to allow National Grid and proposers to complete a number of tasks by 15<sup>th</sup> and 21<sup>st</sup> March. Most of these deliverables were met, apart from the FCC methodology, which was found to contain errors and left many queries unanswered, and the existing contract price impact analysis which was issued less than 2 days before the last workgroup meeting. Both these issues had been discussed at length through the process but the delays and limited time to undertake analysis of prices (the FCC methodology and values are fundamental to the analysis work) and to consider the Baringa report caused much frustration.

With respect to both these issues modifications may have been amended to address the points had more time been available, a non-urgent process would likely have sought an extension.

The reason to flag these issues is so that we might learn from this experience and inform the code governance review. Through the huge efforts of the Joint Office and stakeholders the workgroup report was substantially better than that for 0621 but there clearly remains significant analysis and assessment to be carried out by Ofgem's Impact Assessment.

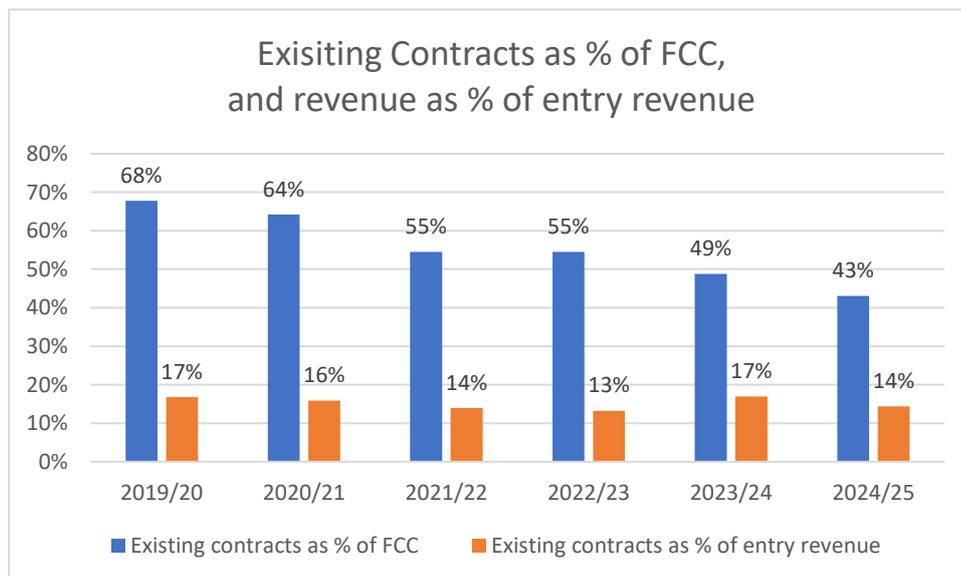
## Consultation Questions Requested by the Authority

The Authority has requested that the following questions be considered by Respondents when writing their responses.

### 1. What impact, if any, do you think tariff differentials between existing and new contracts will have on users booking behaviour?

Firstly, it is useful to consider the magnitude of the issue. Existing contracts remain a feature of the regime until the early 2030's, with booked quantities only falling away significantly beyond 2027. This effectively creates a transition period in excess of 10 years during which time all entry capacity will not be treated equally. As this issue only applies to entry capacity there are clear implications for GB supply and wholesale gas prices. Decisions regarding transmission charging have the potential to impact the GB gas market over the next decade.

The chart below shows the disparity in the quantity of existing capacity and the revenue it recovers. In 19/20 this implies that the remaining 83% of entry allowed revenue will need to be recovered from 32% of the FCC volume. This leads to the average price for newly purchased beach capacity being approximately 10x that of the average existing contract price<sup>5</sup>.



Note: data beyond 2021 assumes flat revenue and FCC values, data is not presented beyond 24/25 due to these uncertainties.

This does not convey the full picture however Figure 2 in the Baringa report<sup>6</sup> analysis provides a breakdown of existing contract price and CWD / PS prices by entry point. This report was only

<sup>5</sup> <http://www.gasgovernance.co.uk/0678/Analysis> see analysis by Vermillion published on 4 March

<sup>6</sup> <http://www.gasgovernance.co.uk/0678/Analysis> Baringa report published 8 April

made available less than two days before the workgroup report was finalised, although Ofgem had requested in its letter<sup>7</sup> for the information to be provided to Workgroup in time to be considered through the full duration of the extended timeline. This analysis therefore received insufficient review and discussion. It is not clear whether the scope of the analysis meets Ofgem's expectations. It is useful to consider this in conjunction with Chart 3 in National Grid's summary note<sup>89</sup>. This shows that the main points where flows exceeded existing contract bookings in 17/18 were Bacton IP, Bacton UKCS, St Fergus and Teesside. The difference here between the existing contract price and the CWD / PS price is roughly x3-4 apart from St Fergus where the factor is close to 1 for PS and slightly less than 2 for CWD. These numbers are much less than the headline value of x10 above but are still significant and may affect decisions to flow particularly at Bacton IP and St Fergus where gas may have the option of flowing to other markets.

Returning to the original question, this is not simple to answer in isolation as there are many factors at play, including;

- Contractual obligations
- Price of new capacity
- Capacity availability
- Whether parties may prefer to trade at NBP or TTF
- To what extent costs can be passed on
- The development of secondary trading in entry capacity – this is currently fairly limited with no standard terms. Noting that once traded entry capacity loses its existing contract status and becomes liable for revenue recovery charges (except storage capacity in 0678C,E,F). Although in some circumstances it may still be cheaper to buy traded capacity with top-up charge than new capacity.

It can however be said with some confidence that shippers will respond to commercial drivers in the market within the contractual constraints they face.

The considerations above will also evolve over time as the volume of existing contracts reduces; for example, Easington is not mentioned above as flows roughly match existing contract bookings, so flow decisions may not be impacted by the new capacity price. However, when existing capacity bookings at Easington decline (bookings reduce gradually through to 2028) flow decisions may well be influenced by the new capacity price, noting here the price differential between existing bookings and new is around 10 for CWD and 15 for PS. Gas arriving at Easington provides a substantial fraction of GB gas demand but is also physically able to flow to continental Europe, if netback prices are attractive.

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<sup>7</sup> <https://www.ofgem.gov.uk/publications-and-updates/unc0678-amendments-gas-transmission-charging-regime-timetable-extension-unc678>

<sup>8</sup> <http://www.gasgovernance.co.uk/0678/Analysis> Existing contracts summary note 8<sup>th</sup> April

<sup>9</sup> Baringa report Figure 12 shows that over booking in 2021/22 is mostly limited to storage and LNG entry points

It therefore remains a concern to Energy UK that the analysis was produced so late in the process when the issues have been flagged extensively during the mod 0621 process, too late for proposers to consider amending their proposals, particularly as National Grid chose not to, if it had, others would have followed. We understand and acknowledge the Baringa report identifies that there are multiple influences on the wholesale price and hence customer welfare. Essentially it is not easy to disentangle the factors affecting the NBP price. However, the competitive advantage for existing contract holders with lower tariffs is acknowledged, it is likely that the sale of new entry capacity, as the marginal price, will be a contributor to setting the NBP price, and consequently electricity prices. We would argue that where there is a difference between market factors driving prices and regulated transmission tariffs creating a distortion, the latter should be avoided by all means possible. This advantage comes from the TAR NC code providing reserve price protection for existing contract holders and GB changing its charging regime to achieve compliance with other aspects of TAR NC, particularly the focus on capacity-based charging. Even so whilst compliance with Article 35 must be achieved, it seems somewhat remiss not to try and address this competitive distortion by consideration of decisions which are within the scope of the GB arrangements, recognising that the specific nature of the historical capacity and charging regime in GB can lead to unintended consequences in the transition.

Baringa considered a number of options to reduce the price differential. National Grid commented that these may be considered in the future. With the greatest distortion being from the implementation of any 0678 variant we consider this should be addressed **now**. The only proposals that go some way to address this are 0678C,E,F,G,H by applying revenue recovery charges on existing contracts (apart from storage) but with the revenue recovery charge expected to be small the impact will also be small. However, the magnitude of the revenue recovery charge is unknown and depends on National Grid's forecast error, giving rise to uncertainty in transportation charges. If the revenue recovery charge were to be negative then the impact could be perverse.

Baringa does not seem to have considered in any detail an option of retaining the existing capacity, volume and revenue in the RPM for the determination of reference prices. This reduces the price differential but creates an under-recovery which will decrease over time as existing contracts expire. The under recovery could then be recovered from all flows (exempting storage) as a commodity charge which is provided for in TAR NC Article 4. Such an approach may also reduce a significant step change in DN revenue and hence effectively create a phased approach for DN connected customers including domestics. With an increasing capacity charge and reducing commodity charge proportion over time. However, we note that Ofgem in its 0621 decision letter favoured capacity-based charges, but whether this is best for customer welfare remains unclear and must be addressed in a regulatory impact assessment.

Baringa also suggested other mitigating measures, including a change to the entry / exit split, this is also worthy of further consideration as the impact on NBP prices of the cost of new entry capacity may be reduced. We reiterate our concern that this issue needs to be addressed before implementation of these charging reforms.

## **2. What date should the changes proposed by the modifications become effective and why?**

1 October 2020, or a 1 October date after that.

1 October 2019 is not achievable unless Ofgem makes a decision within a few days of receiving the final modification report, and does not undertake an impact assessment nor carry out its consultation obligations under Articles 26,27 and 28 of TAR NC.

Given the notification timescales any dates other than 1 October may not be compliant for the reasons set out in SSE's QC legal advice<sup>10</sup>. Any mid-year implementation dates would also impact trading positions already established and customer contracts which may span several years. If Ofgem wishes to consider a mid-year implementation date we would suggest it issues a request for information of the impacts as it did during its consideration of UNC Modification Proposal 0636.

Consideration also needs to be given to step changes that may occur as we move into RIIO T2 and the impact of K factors.

**3. The proposals have different specific capacity discounts for storage sites. What level of storage discount do you consider is appropriate and can you provide clear justification if the discount is greater than 50%?**

The 0678 proposals include a storage discount of 50% or 80%, for the purposes of TAR NC both are compliant being at least 50%. For the proposals which contain an 80% discount additional justification has been provided, given the material impact on storage facilities, which seems reasonable given the value of storage to the market and its role in security of supply. Ofgem should consider whether the cost increase of 1-2% for other capacity is justified and represents good value for money. Also whether this is the most appropriate means to provide support for storage, whether 80% is sufficient and whether some facilities may benefit more than others.

The material impact on storage facilities arise as they are currently exempt from commodity charges and utilise off-peak exit capacity, but the proposals price off-peak capacity at almost firm levels and removes the TO commodity charges with the revenue incorporated in capacity charges, from which storage facilities are not exempt.

Many gas generation sites, face a similar impact in the charges they face, but Ofgem does not seek views on the impact on these sites. Many generators use off-peak capacity and a good proportion are located close to entry points so they can also utilise the shorthaul charge. Ofgem's 0621 decision letter<sup>11</sup> noted the following:

*We estimate that over 75% of transmission-connected power stations would face a decrease in tariffs compared to the status quo,*

Even when additional information from the consultants was published, it was not clear how they had arrived at this conclusion. We believe this is flawed and can only assume that the use of off-peak capacity and shorthaul arrangements was ignored in some idealised analysis. We note that

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<sup>10</sup> <http://www.gasgovernance.co.uk/0678> published on 6 March 2019

<sup>11</sup> <https://gasgov-mst-files.s3.eu-west-1.amazonaws.com/s3fs-public/ggf/page/2018-12/Ofgem%20Decision%20Letter%200621.pdf>

information on off-peak capacity bookings is publicly available from NG's data explorer, therefore the status quo position is clear (around 50% of all gas generation exit capacity is booked as off-peak). Ofgem must consider the impact on competition as to how the charging proposals affect gas fired generators, in particular Ofgem must ensure that the baseline starting point is the current arrangements at a level of detail that considers off-peak capacity utilisation and use of shorthaul. Failure to do so will not only provide misleading conclusions but also skew the impacts on other customers and electricity prices.

**4. Can you provide reasons why an NTS Optional Charge is or is not justified? If you consider an NTS Optional Charge is justified, which proposal do you prefer and why is it compliant with TAR NC?**

The NTS Optional Charge has been a feature of the gas transmission charging regime for over 20 years. It was introduced to disincentivise the development of private pipelines for routes already served or which could readily be served by the transmission system. Such private pipelines would reduce revenue to National Grid whilst providing commercial benefits to the connected parties, the optional charge was introduced to offset these commercial benefits and avoid unnecessary investment in what may be duplicate pipelines, therefore avoiding inefficiency and disbenefits to end users.

These principles remain robust today, so an appropriate optional charge seems justified.

Whilst the optional charge formula was designed to be cost reflective other aspects of the regime have changed which led to it being a favourable option over longer distances than originally intended. It is therefore appropriate to update the arrangements and to ensure the arrangements are compliant with TAR NC.

A number of proposals include the provision for an optional charge, whilst there is also a review group 0679R considering optional charge options. If a 1 October 2020 Effective date is chosen for any proposal then we consider there may be sufficient time for 0670R to progress work on an optional charge for implementation on the same date. So, this should not preclude 0678 variants that do not include an optional charge being progressed, although early clarity on this issue is preferred. We are however concerned that separating the consideration of an optional charge from the main 0678 proposals may lead to an optional charge solution not being progressed at all, Ofgem did comment in its UNC modification proposal 0636 decision letter<sup>12</sup> that:

*Given the wider scale reform currently under consideration, we think that the OCC should not be looked at in isolation, but should be considered holistically in the context of the wider charging landscape*

Ofgem will therefore need to consider this very carefully in its decision on the proposals and any additional directions that it makes in this regard.

Two main mechanisms are proposed for an optional charge, one derived from the CWD methodology, the other updates the existing formula and establishes this as a capacity-based charge, the wheeling charge is really a special case of the latter where the distance = 0 km.

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<sup>12</sup>

<https://gasgov-mst-files.s3.eu-west-1.amazonaws.com/s3fs-public/ggf/book/2018-07/Ofgem%20Authority%20Decision%20Letter%20UNC0636%20310718%20D.pdf>

These proposals all provide for the optional charge to be capacity based and provide the same arrangements at IPs and non-IPs thereby addressing two of the issues in Ofgem’s rejection letter of UNC proposal 0621<sup>13</sup>. Ofgem was also concerned about the cost reflectivity of the proposals included in the 0678 modifications. Cost reflectivity as a concept has been discussed extensively during the 0678 workgroup meetings, as it is not explicitly defined workgroup considered that it was difficult to assess the proposals against this relevant objective.

We offer some observations in this regard:

- The CWD methodology creates high exit charges at points close to entry points, this perverse outcome is offset to some extent by the optional charge, enhancing the cost reflectivity of these proposals.
- 0678B establishes an optional charge using the parameters within the CWD methodology and at the highest level uses the parameters of capacity and distance which TAR NC considers lead to cost reflective charges. This approach also provides for greater transparency than other approaches.
- Proposals based on updating the existing formula use cost-based inputs so the charge is expected to be cost reflective overall and so could be more cost reflective than other aspects of the proposals.

Energy UK undertook some simple analysis on the revenue that could be obtained from just three offtake points that are very close to entry points <10km. These represent points that could consider building a private pipeline from the entry point.

NTS Offtake	CWD 19/20 price	FCC 19/20 as at 20/3/19	Capacity cost £	Linked Entry point	CWD 19/20 price	capacity cost £
Grain	0.0167	48,815,174	2,976,865	Isle of Grain	0.0316	5,629,692
Peterhead	0.0254	73,267,750	6,792,653	St Fergus	0.0601	16,070,691
Pembroke	0.0209	121,200,000	9,255,627	Milford Haven	0.0470	20,791,136
		Total	19,025,145		Total	42,491,519

Using the 19/20 CWD prices and FCC values this gives a total of £61.5M or 9% of Transmission Services allowed revenue for that year (non-transmission services revenue is not considered). If these three sites built private pipelines and took no gas from the NTS then this revenue would need to be recovered from other capacity holders, leading to an increase in charges for all capacity. An optional charge for these sites would mean that some revenue is collected or flows to

<sup>13</sup> <https://www.ofgem.gov.uk/publications-and-updates/uniform-network-code-unc-621-abcdehijkl-amendments-gas-transmission-charging-regime>

these sites rather than potentially none if private pipelines are built, this would therefore mitigate the price increase to other capacity, both entry and exit.

We note that the £61.5M figure above is not completely at odds with the values of 'under recovery' in the National Grid optional charge analysis<sup>14</sup>. We accept this is a simplistic comparison since only three sites are considered and NG's calculations include revenue from the optional charge.

However, we consider this supports an optional charge being a feature of the charging arrangements, whilst the detailed design seeks to strike a balance between the applicability of the tariff and the cost impact to other capacity holders.

Shorthaul products are mentioned in the recent ACER report<sup>15</sup> on the conditionalities in contracts for standard capacity products for firm capacity. However, the main focus seems to be on conditionalities where a product is interruptible rather than firm because of network conditions. In this regard ACER is concerned about the completion of the entry-exit system, access to trading hubs and impact on liquidity. There does not seem to be any specific commentary on a conditional product being offered to reduce the incentive to avoid bypass of the transmission system and the associated loss of revenue if a bypass pipeline were built.

In GB, sites that utilise the shorthaul tariff are connected to the transmission system and so are part of the entry exit system, they do have access to the NBP, and the NBP market is liquid so the shorthaul tariff has limited, if any, impact on this. Also, the Bacton ASEP and IP exit point benefit from the shorthaul arrangements, supporting cross border trade. It is therefore hard to draw any conclusions from the ACER report that apply to GB as these mostly relate to investment and a CBA to remove conditionalities. In the GB context the CBA would need to consider the cost to other parties if bypass pipelines were built and transmission revenue recovered from a smaller capacity / demand base.

As a final point Energy UK has been advised that several generators are now working on private pipeline alternatives to NTS supply.

## **5. Do you consider the proposals to be compliant with relevant legally binding decisions of the European Commission and/or the Agency for the Co-Operation of Energy Regulators?**

Compliance assessments are included for each proposal, each proposer considers its proposal to be compliant. These issues are considered at length in the workgroup report which also notes that

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<sup>14</sup> <https://gasgov-mst-files.s3.eu-west-1.amazonaws.com/s3fs-public/ggf/book/2019-04/Optional%20Charge%20Analysis%20%28National%20Grid%29%20v1.3.pdf>

<sup>15</sup> [https://www.acer.europa.eu/Official\\_documents/Acts\\_of\\_the\\_Agency/Publication/ACER%20Report%20on%20the%20conditionalities%20stipulated%20in%20contracts%20for%20standard%20capacity%20products%20for%20firm%20capacity.pdf](https://www.acer.europa.eu/Official_documents/Acts_of_the_Agency/Publication/ACER%20Report%20on%20the%20conditionalities%20stipulated%20in%20contracts%20for%20standard%20capacity%20products%20for%20firm%20capacity.pdf)

compliance is ultimately for judges or the CMA to decide. Ofgem will need to seek its own legal view on compliance whilst noting legal views on certain topics have already been shared with the industry which do not agree on specific issues.

Notwithstanding this there are some areas that Energy UK considers may not be fully compliant, these include:

Article 7 requires users to be able to reproduce the calculation of reference prices and their accurate forecast.

Some Energy UK members have found that the values that inform the derivation of the FCC values do not correspond with data published by National Grid and accessed via data explorer. Such discrepancies are a concern, the input data and model require audit and validation prior to charge setting.

The 'updated forecast' used in the derivation of FCC values is not publicly available. Whilst National Grid has published current values, values are likely to change year on year as the 'updated forecast' evolves. There is no understanding or transparency about this process, which means there is no confidence in future years FCC values, which limits users ability to forecast charges accurately.

Users ability to forecast charges accurately may also be compromised by a potential flaw in the methodology that uses the 'maximum of' a number of parameters. Unfortunately, with the methodology being produced so late in the process there was limited time to assess alternative approaches and sensitivities.

Some proposals that allow for implementation on a date other than 1 October may lead to non-compliance if Ofgem determined the effective date should be a date mid way through the gas year. This is because of the way in which TAR and CAM work together. CAM article 9 defines standard capacity products, with the yearly product starting on 1 Oct. TAR Articles 12.3, 29, 32 require reserve prices to be published 30 days before the yearly capacity auction and to be binding for the gas year. For more detail see SSE QC legal advice as referenced in (2) above.

- 6. It is proposed that National Grid Gas may review or update the Forecasted Contracted Capacity (FCC) Methodology following consultation with stakeholders, unless Ofgem (upon application by any Shipper or Distribution Network Operator) directs that the change is not made as per its powers under Standard Special Condition A11(18) of National Grid's Licence. Do you believe that this governance framework is fit for purpose? Please provide reasons for your answer.**

Energy UK notes that proposals 0678B and 0678C provide for the FCC methodology to be included within the UNC and hence subject to UNC governance which provides for stakeholders to raise proposals for change with defined, transparent and well understood processes for managing that change. Other proposals lack a clear mandate for a review by National Grid or a review being instigated by other parties, this is a concern.

The FCC methodology is a key part of the overall charging arrangements in that it determines a set of data inputs to the reference price methodology. The charging arrangements were included in the UNC as part of a code governance review several years ago and so it seems appropriate to include this methodology within the code too.

Energy UK has long supported the inclusion of other methodology statements relating to capacity release and substitution to be included in the UNC to provide better governance of these statements but that is yet to happen. This leaves parties having to convince National Grid to progress a change, which it may or may not do, or raise a UNC modification proposal on a specific aspect of those statements as is the case with current UNC proposals 0667, 0671.

## Appendix 1

### Copy of observations on the FCC methodology and values submitted to the Joint Office by Energy UK on 21 March 2019.

#### Methodology

1. Methodology document needs to include aggregate or sum of in every section for clarity. Else divide by number of days makes no sense.
2. It is not clear if future annual bookings are considered?
3. Justification of selection of parameters as per TAR NC article 26 1 (a) i, is absent
4. There is no justification provided for a different approach for GDN offtakes Y-1 vs Y -2 at all other offtakes, this allows adjustments up/down to be reflected more rapidly in GDN values than for other sites
5. Why are PARCA reservations / bookings are not incorporated into the GDN FCC values
6. The use of Y-1 seems to implicitly assume no short-term bookings by GDNs – can this be demonstrated / guaranteed. Does UNC prevent DN Users from making short term bookings?
7. Updated Forecast – appears to be a defined term, is it defined in the new legal text, it is not in the current UNC defined terms listings?
8. Does the Updated Forecast relate to a particular scenario?
9. Is it a peak day forecast?
10. The GTYS charts and data SS does not contain data at the granularity required for FCC.
11. How are site specific values determined?
12. What values are used for new sites, without a PARCA reservation?
13. Exceptions in Chapter 4: a means to deal with difficult issues but does not seem to have been applied to FCC in ss NG specifically says it is not using exceptions, but will do later for actual charges – presumably in some unpredictable random way

#### Values

1. Storage sites and interconnectors still have no forecast values – which leads to a query of the forecast used
2. Avonmouth refill,, Deeside<sup>16</sup>, Rough injection, Glenmavis injection, Gowkhal ( Longannet), Dynevor refill, Rough refill, have FCC values for all 6 years from flows or bookings in 2017/18, but are closed – surely this should be covered by exception rule?
3. Bacton GDN – it is not clear if the FCC includes the PARCA capacity from 1/3/21 , FCC falls then is flat
4. Ipsden and Ipsden 2 have PARCA bookings from 1/2/19 but the FCC values are below these
5. Keadby blackstart has 0 forecast values until 2022 then sizeable values appear?
6. Mappowder 19/20 FCC is below PARCA quantity
7. Peterborough EYE (TEE) and Silk Willoughby not clear that PARCA bookings from 1/3/21 are included in FCC values which are flat at the booked level of 17/18
8. Peterhead has no forecast from 2022, so is assumed to close ?

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<sup>16</sup> <http://www.tritonpower.co.uk/deeside>

9. Knottingley PS has forecast values from 2022 ,but no PARCA
- ~~10. Hirwuan PARCA reservation should start on 1/10/20~~
- ~~11. Drax PARCA reservation values are missing~~
- ~~12. Tilbury Marshes is missing but has PARCA reservation from 1/12/20~~
13. Treatment of Theddlethorpe and Caythorpe needs considering

The items struck through were addressed between the FCC published on 15<sup>th</sup> and 20<sup>th</sup> March