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By Email

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Representation - UNC Modification 0678, 0678A, 0678B, 0678C, 0678D, 0678E, 0678F, 0678G, 0678H, 0678I and 0678J– Amendments to Gas Transmission Charging Regime

A. Introduction

1. Summary of SHG position

1.1. **Support (Preference)**

0678J

1.2. **Oppose (with comments)**

All other Modifications

2. Basis of SHG Response

2.1. While the suite of proposed 0678 Modifications contain many similarities, South Hook Gas Company Ltd (**SHG**) considers that many of the differences between the individual Modifications are significant both conceptually and in terms of the materiality of their impact if implemented.

2.2. Rather than addressing each specific proposed Modification in detail, which would be a duplicative and onerous exercise given the number of proposed Modifications and combinations of positions on the key matters at issue therein (eg RPM, FCC, Existing Contacts, revenue recovery etc), SHG has provided its analysis in paragraphs below on each of these key matters, including whether they would have a positive or negative impact if implemented.

2.3. SHG has provided a summary of views for each of the Modifications measured against the Relevant Objectives in Appendix 1.

2.4. For an overview of SHG's reasoning for supporting/opposing each Modification please see Appendix 2.

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B. Reasons for supporting/oppose elements of Modifications

3. Reference Price Methodology (RPM)

3.1. SHG agrees with the conclusions from the 0621 and 0678 workgroups[1] that the current LRMC charging methodology is no longer suitable for calculating cost-reflective NTS capacity prices and therefore a change to the methodology is required.

3.2. It is widely accepted that, given the low levels of future investment expected in the NTS, an RPM which seeks to recover revenue, such as the Capacity Weighted Distance (**CWD**) or Postage Stamp (**PS**) methodologies, is more appropriate than the current forward-looking LRMC approach. Within the suite of 0678 Modifications, both CWD and PS RPMs have been proposed.

3.3. SHG believes PS is the more appropriate RPM as the weighted average distance element of the CWD (which takes the average distance from an Entry Point to all Exit Points) is not representative of how the NTS is used[2], leading to costs being incorrectly allocated to certain users on the systems, and could result in prices being set in a discriminatory manner. It is not possible to allocate historic costs to specific points, or routes, on the NTS and therefore the cost driver proposed within the CWD modifications is inappropriate. PS is a pragmatic methodology that is both simple and encourages competition by creating a level playing field for capacity prices while being fair for end users.

4. Forecasted Contracted Capacity (FCC)

4.1. One of the main inputs to the calculation of capacity price within the RPM is the FCC. It is imperative therefore that the FCC calculation methodology is as accurate as possible in order to produce predictable charges that minimise under- or over-recovery.

4.2. Given the behavioural changes that are expected to occur from the amendment to the gas transmission charging regime SHG believes that it is appropriate to have a flexible

[1] https://gasgov-mst-files.s3.eu-west-1.amazonaws.com/s3fs-public/ggf/book/2018-04/%23%203%20RPM%20Sensitivity%20Analysis%20-%20Slide%20Pack%20v2.0.pdf

[2] As highlighted in 0678J Supporting Documentation, found at: https://gasgov-mst-files.s3.eu-west-1.amazonaws.com/s3fs-public/ggf/book/2019-04/Modification%200678J%20Views%20on%20Analysis_0.pdf

process for the FCC calculation methodology in the short term and therefore believe the calculation should sit outside the UNC at the current time. However, in the longer term, we would expect to see the FCC calculation methodology moved into UNC to provide for greater certainty around the governance process.

4.3. The calculation methodology for FCC currently proposed by NGG[3] uses the maximum value of a series of gas input scenarios to estimate gas supply. This creates the risk of overstatement of gas supply, leading to an under-recovery of revenue which, in turn, would result in unnecessary top up charges being incurred.

4.4. As part of the proposed FCC calculation methodology, NGG envisage that exceptions may be made where NGG believe the FCC values calculated (as per Section 2, or 3 for GDNs) are incorrect. Given the inherent tendency towards overstatement of gas supply in the calculation methodology, SHG believes that there should be greater detail around the proposed process for correction of identified inaccuracies and consultation of FCC figures calculated as "exceptions".

4.5. Given the importance of the FCC values in generating the charges, SHG believes that NGG should publish the FCC values ahead of the charges being calculated to allow for greater transparency. As part of this publication, SHG believes that NGG should also identify, in respect of any FCC calculations reopened in accordance with paragraph 4.4 above:

4.5.1. the specific values recalculated as "exception" in accordance with paragraph 4.4 above;

4.5.2. why NGG believe the calculated value or values are incorrect;

4.5.3. what methodology was used to calculate the new value or values; and

4.5.4. why this new methodology was deemed appropriate.

SHG strongly feels that, if NGG provides wider consultation on the calculation and re-calculation of FCC values, a better methodology will be developed that more accurately predicts the FCC.

4.6. These provisions have been included as part of UNC Modification 0678J.

[3] https://gasgov-mst-files.s3.eu-west-1.amazonaws.com/s3fs-public/ggf/book/2019-03/Forecasted%20Contracted%20Capacity%20v1.0_0.pdf

5. Existing Contracts

5.1. All proposals "net off" Existing Contracts[4] from the FCC to determine the level of capacity that is expected to (1) be booked in the coming gas year and (2) be subject to the calculated capacity reservation prices. SHG believes that netting off is appropriate as the exclusion of "Existing Contracts" from the FCC would result in an under-recovery which would be contrary to the EU TAR requirement that transmission service revenue be recovered mainly through capacity charges.

5.2. In respect of the above, SHG would highlight the findings of the report that Baringa conducted[5] on behalf of NGG as part of the 0678 process. Baringa determined that any differential in the price of existing and new capacity is a result of legal provisions under TAR NC and is not designed to incentivise any particular economic behaviour[6]. They also identified that any impacts of such price differentials on consumer welfare and the broader gas market are unlikely to be material or long-lasting, due to the number of Existing Contracts tapering over time as they expire or are terminated.

5.3. As a result of the above SHG believes the "netting off" approach proposed in all of the Modifications is the appropriate way to treat Existing Contracts in the RPM.

5.4. TAR NC Article 35(1) states that "this Regulation shall not affect the levels of transmission tariffs resulting from contracts or capacity bookings which concluded before 6 April 2017 where such contracts or capacity bookings foresee no change in the levels of the capacity and/or commodity based transmissions tariffs except for indexation, if any". SHG agrees with Eni Trading and Shipping's legal opinion[7] that the correct interpretation of this Article should be that existing contracts should be excluded from the application of a new capacity based revenue recovery charge.

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[4] As defined in EU TAR NC Article 35(1)

[5] Found at: https://gasgov-mst-files.s3.eu-west-1.amazonaws.com/s3fs-public/ggf/book/2019-04/Tariff%20differentials%20between%20new%20and%20existing%20contracts%20-%20Baringa%20report.. .pdf

[6] Conclusions (page 29) of Baringa Report

[7] https://gasgov-mst-files.s3.eu-west-1.amazonaws.com/s3fs-public/ggf/book/2019-02/Eni_Article%2035_Legal%20Opinion.pdf

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6. Revenue Recovery

6.1. SHG believes that all Existing Contracts should be exempt from the Transmission Service Revenue Recovery charge.

6.2. Existing Contracts were concluded under the current transmission charging regime and costs under these contracts are generally classified as sunk costs by procurers. A number of these contracts were executed to satisfy the relevant User Commitment tests and signal investment on the NTS. Therefore these contracts were required to be procured at peak levels, which the counterparties recognised were not reflective of the user's ability or intention to consistently utilise.

6.3. SHG recognises the argument that these Existing Contracts were concluded in the knowledge that a revenue recovery charge would be applicable. However this revenue recovery charge would only have been understood to be applicable to capacity that was utilised.

7. Multipliers

7.1. SHG welcomes the proposals to apply multipliers of one (1) for all capacity products on the NTS as this removes the current cross-subsidisation which has arisen as a result of free, or heavily discounted, short-term capacity.

7.2. Given that the increased price of capacity under all scenarios promotes the restriction of capacity acquisitions by users to such capacity that the user is reasonably certain will be used on a day, SHG believes there is a case for a discount on long term capacity for flexible sources of gas as this may encourage gas suppliers to secure additional capacity to be responsive to changing demand levels.

8. Interruptible Discount

8.1. As with multipliers at paragraph 7 above, SHG welcomes the proposal to remove free interruptible capacity and agrees that the initial discount of 10% and a banding approach as proposed in all Modifications is a pragmatic approach on this point.

9. Specific Capacity Discounts

9.1. Storage Discounts

9.1.1 The proposed amendments in respect of all Modifications under 0678 include either a 50% or 80% discount to Storage capacity reserve prices. The

Modifications (including 0678J) that propose a 50% Storage discount are compliant with the minimum discount (ie 50%) required under EU TAR[8].

9.1.2 SHG cannot provide any insight into the 80% discount as it is heavily based on the economic status of Storage facilities. While the materiality of an 80% discount on other users is minimal, the discount would result in a cross-subsidy by Non-Storage users in favour of Storage users.

9.1.3 Therefore, we believe it is for Ofgem to decide, as part of their decision and any Impact Assessment, whether an additional discount above the 50% prescribed in EU TAR NC discount is appropriate and results in wider benefits to the GB system, or whether the 50% Storage discount as proposed in Modification 0678J (among others) is sufficient for these purposes.

9.2. LNG Discounts

SHG welcomes the inclusion of an LNG discount within UNC, which will expedite the implementation of any future decision to amend the extent of such LNG discount.

9.3. Ireland Security Discount

As above for Storage Discounts, SHG cannot adequately comment on the issue of whether the Moffat IP can be classed as "ending the isolation of a member state"[9] and therefore should be subject to a discount. We would welcome clarity on the rationale for restriction of the proposed discount[10] to flows from UK Beach Terminals rather than more general application to such discount to flows from other Entry Point categories.

10. NTS Optional Charging Arrangements

10.1. SHG supports the principle of an NTS Optional Charge (or **Shorthaul**) that encourages the use of the NTS and avoids inefficient bypass. SHG believes that the removal of the current Optional Commodity Charge without a replacement would result in investment in private pipelines resulting in Users bypassing the NTS which could have a significant detrimental impact on the GB system.

[8] EU TAR NC Article 9(1)

[9] UNC Modification 0678I Paragraph 3.24

[10] UNC Modification 0678I Paragraph 3.32

10.2. As part of Modification 0678J, SHG has proposed an NTS Optional Charging solution[11] that employs a methodology based on updated cost inputs and therefore we believe reflects the risk of users bypassing the NTS[12]. This NTS Optional Charging solution is also incorporated in Modifications 0678D, 0678G and 0678H.

10.3. Irrespective of whether the CWD or PS RPM is used, high capacity prices are calculated for Entry and Exit points which are geographically close to one another, resulting in costs over the short-term that are in excess of those associated with building a private pipeline.

10.4. Appendix 3 sets out a comparison of estimated private pipeline costs compared to both CWD and PS capacity prices for four NTS Exit Points. This analysis indicated that a private pipeline could be built to all three of these Exit Points from the respective Entry Points and that the project investment costs for these private pipelines would be returned within a maximum of 3 years. SHG is concerned that approving a modification that does not include an NTS Optional Charge is likely to provide users with an immediate incentive to bypass the NTS.

10.5. In response to Ofgem's consultation question four (4), SHG, VPI Immingham LLP (Vitol), EP UK Investments Limited and Saltend Cogeneration Company Ltd (Triton Power) have together obtained a legal opinion on the compliance of the NTS Optional Capacity Charge (as contained within Modifications 0678J, 0678D, 0678G and 0678H) with EU TAR NC and Regulation (EC) 715/2009. In summary the legal opinion finds that the NOCC is compliant with both TAR NC and the Regulation. The full opinion can be found in Appendix 4.

10.6. SHG believes the proposed NTS Optional Charging arrangements proposed under Modification 0678J (and 0678D, 0678G and 0678H) are the most appropriate approach on this matter as they seek to replicate the cost of a private bypass pipeline in a pragmatic way.

[11] UNC Modification 0678J Section 5

[12] Justification and analysis can be found at: https://gasgov-mst-files.s3.eu-west-1.amazonaws.com/s3fs-public/ggf/book/2019-04/Modification%200678J%20Views%20on%20Analysis_0.pdf

10.7. In respect of alternative proposals for treatment of OCC under other Modifications, SHG believes that:

10.7.1. the zero distance limit under the Modification 0678I "Wheeling Charge"[13] would result in bypass pipelines still being built and therefore does not fully reflect the risk of bypass pipelines being built; and

10.7.2. the arrangements proposed under Modification 0678B are not justified and would result in a larger uptake of OCC rates compared to the current baseline. Insufficient analysis has been performed on the potential full impact of this change. The primary justification for the arrangements is to rectify the limitations of the distance driver within CWD. SHG submits that, if this is considered to be an issue, the deficiency should be resolved by proposal of a fundamentally different RPM rather than by amendments to the NTS Optional Charging arrangements.

C. Additional Information

11. Interface with Capacity Regime

11.1. UNC Modification 0678 (and 0621) is solely focussed on the Charging methodology. SHG is concerned that a disconnect will arise between the Charging and Capacity regimes for the period between amendment of the Charging regime and the amendment of the Capacity regime.

11.2. A disconnect between the two regimes could have a material impact upon the release of both incremental and substituted capacity. For example, in the case of a PARCA met through substitution, the applicable User Commitment tests requires 16 quarters of capacity to be reserved for Entry and 4 years of enduring capacity for Exit[14]. This test could result in a User Commitment amount that is more than the funded incremental cost of releasing that capacity or the cost of building a private pipeline, disincentivising the use of substitution, and potentially the NTS in general.

12. Views on Implementation Leadtime

12.1. SHG believes that the proposed changes should become effective from 01 October 2019 or as soon as practically possible afterwards in line with an Ofgem decision.

[13] UNC Modification 0678I, Page 26

[14] UNC TPD Section B Paragraph 1.17.7(c)(ii)

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13. Analysis

13.1. SHG has some reservations in respect of the extent of the analysis performed in support of the process. Much of the information and modelling required to assess proposed Modifications was provided late and there has been insufficient time for a thorough review and critique of any analysis performed[15].

14. Legal Text

14.1. We believe that the legal text provided is sufficient to deliver the proposed solutions, however we have not had time to do a full review of the legal text for all Modifications and the final legal text will obviously need to be reflective of the final Modification selected.

We hope this response is of assistance. If you require any further information or wish to discuss any aspects of this response please do not hesitate to contact me via phone (07787 524 566) or email (abates@southhookgas.com).

Yours sincerely

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[15] As per various comments in Part I of Draft Modification Report

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Appendix 1 – Standard and Charging Relevant Objectives

There are a number of elements within individual proposals that can have a positive or negative impact on the individual relevant objectives. We have tried to weigh up the different elements within each proposal to determine whether or not the overall proposal furthers the individual relevant objectives. Please note our comments above for the different aspects of the proposals and their impacts.

Standard Relevant Objectives

	a)	b)	c)	d)	e)	f)	g)
0678	Negative	None	None	Negative	None	None	Positive
0678A	Negative	None	None	Negative	None	None	Positive
0678B	Negative	None	None	Negative	None	None	Positive
0678C	Negative	None	None	Negative	None	None	Negative
0678D	Negative	None	None	Negative	None	None	Positive
0678E	Negative	None	None	Negative	None	None	Negative
0678F	Negative	None	None	Negative	None	None	Negative
0678G	Negative	None	None	Negative	None	None	Negative
0678H	Negative	None	None	Negative	None	None	Negative
0678I	Negative	None	None	Negative	None	None	Positive
0678J	Positive	None	None	Positive	None	None	Positive

Charging Relevant Objectives

	a)	aa)	b)	c)	d)	e)
0678	Negative	Negative	Negative	Negative	None	Positive
0678A	Negative	Negative	Negative	Negative	None	Positive
0678B	Negative	Negative	Negative	Negative	None	Positive
0678C	Negative	Negative	Negative	Negative	None	Negative
0678D	Negative	Negative	Negative	Negative	None	Positive
0678E	Negative	Negative	Negative	Negative	None	Negative
0678F	Negative	Negative	Negative	Negative	None	Negative
0678G	Negative	Negative	Negative	Negative	None	Negative
0678H	Negative	Negative	Negative	Negative	None	Negative
0678I	Negative	Negative	Negative	Negative	None	Positive
0678J	Positive	Positive	Positive	Positive	None	Positive

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Appendix 2 – High level overview of each Modification proposal

Modification	*Support or Oppose*	*Reason for Support/Opposition*
0678	Oppose	- The CWD reference price methodology results in prices which are not cost reflective, create distortions and are detrimental to competition. - The lack of an optional charge could result in inefficient and uneconomic operation of the NTS and less cost reflective charges than those containing an optional charge solution
0678A	Oppose	- The lack of an optional charge could result in inefficient and uneconomic operation of the NTS and less cost reflective charges than those containing an optional charge solution
0678B	Oppose	- The CWD reference price methodology results in prices which are not cost reflective, create distortions and are detrimental to competition. - The Optional Charge contained within the solution is too accessible and does not further the relevant objectives
0678C	Oppose	- The lack of an optional charge could result in inefficient and uneconomic operation of the NTS and less cost reflective charges than those containing an optional charge solution - Not consistent with EU TAR on Existing Contract protection
0678D	Oppose	- The CWD reference price methodology results in prices which are not cost reflective, create distortions and are detrimental to competition.
0678E	Oppose	- The CWD reference price methodology results in prices which are not cost reflective, create distortions and are detrimental to competition. - The lack of an optional charge could result in inefficient and uneconomic operation of the NTS and less cost reflective charges than those containing an optional charge solution - Not consistent with EU TAR on Existing Contract protection
0678F	Oppose	- The CWD reference price methodology results in prices which are not cost reflective, create distortions and are detrimental to competition. - The lack of an optional charge could result in inefficient and uneconomic operation of the NTS and less cost reflective charges than those containing an optional charge solution - Not consistent with EU TAR on Existing Contract protection - The ability to surrender the capacity purchased in the 2018 QSEC Auction could undermine future investment in the NTS
0678G	Oppose	- The CWD reference price methodology results in prices which are not cost reflective, create distortions and are detrimental to competition. - Not consistent with EU TAR on Existing Contract protection
0678H	Oppose	- Not consistent with EU TAR on Existing Contract protection
0678I	Oppose	- The CWD reference price methodology results in prices which are not cost reflective, create distortions and are detrimental to competition. - The Optional Charge contained within the solution does not fully reflect the risk of those able to bypass the NTS
0678J	Support (Preferred)	- The modification was raised to be a complete solution based on the comments above

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Appendix 3 – Further NTS Optional Capacity Charge Analysis

	Annual CWD Cost	*Annual PS Cost*	*Cost of Private Pipeline*
Pembroke Power Station	£42,512,718	£36,982,968	£12,251,657
Peterhead Power Station	£30,352,997	£22,356,921	£4,666,320
Bacton (IUK) Interconnection Point	£45,956,122	£56,582,207	£7,994,581
VPI Immingham CHP	£15,700,110	£20,444,380	£38,693,710

Assumptions

Distance is from the closest (Non-Storage) Entry Point in the CWD distance matrix

Obligated baseline has been used for MNEPOR

FCC from NGG's 0678 sensitivity tool is used

Annual pipeline cost (as per Mod 0678D/G/H/J) is multiplied by the annuitisation factor of 6.76 to get the total pipeline cost

Annual CWD and PS costs include Entry and Exit Capacity costs and Non-Tx Service Revenue Recovery

2019/20 CWD and PS charges have been calculated from NGG's sensitivity tool