

Representation - Draft Modification Report

UNC 0621; 0621A; 0621B; 0621C; 0621D; 0621E; 0621F; 0621H; 0621J; 0621K*; 0621L

Amendments to Gas Transmission Charging Regime

*** Amendments to Gas Transmission Charging Regime and the treatment of Gas Storage**

Responses invited by: 5pm on 22 June 2018

To: enquiries@gasgovernance.co.uk

Representative:	Graham Jack
Organisation:	Centrica
Date of Representation:	21 June 2018
Support or oppose implementation?	<p>0621 - Comments</p> <p>0621A - Comments</p> <p>0621B – Qualified Support</p> <p>0621C - Support</p> <p>0621D - Oppose</p> <p>0621E – Qualified Support</p> <p>0621F - Oppose</p> <p>0621H - Comments</p> <p>0621J - Oppose</p> <p>0621K - Oppose</p> <p>0621L – Comments</p>
Expression of Preference:	<p><i>If either 0621; 0621A; 0621B; 0621C; 0621D; 0621E; 0621F; 0621H; 0621J; 0621K or 0621L were to be implemented, which <u>ONE</u> modification would be your preference?</i></p> <p>0621C</p>

Standard Relevant Objective:

0621
a) None
c) Negative
d) Negative
g) None

0621A
a) Negative
c) Negative
d) Negative
g) Negative

0621B
a) Positive
c) Negative
d) Negative
g) None

0621C
a) Positive
c) Positive
d) Positive
g) Positive

0621D
a) Negative
c) Negative
d) Negative
g) Negative

0621E
a) None
c) Negative
d) Negative
g) None

0621F
a) None
c) Negative
d) Negative
g) Negative

0621H
a) None
c) Negative
d) Negative
g) None

0621J
a) Negative
c) Negative
d) Negative
g) Negative

0621K
a) Negative
c) Negative
d) Negative
g) Negative

0621L
a) None
c) Negative
d) Negative
g) Negative

Charging Methodology Relevant Objective:	0621 a) Negative aa) Negative b) Positive c) Negative e) None
	0621A a) Negative aa) Positive b) Positive c) Negative e) Negative
	0621B a) Positive aa) Positive b) Positive c) Negative e) None
	0621C a) Positive aa) Positive b) Positive c) Positive e) Positive
	0621D a) Negative aa) Positive b) Positive c) Negative e) Negative
	0621E a) Negative aa) Positive b) Positive c) Negative e) None
	0621F a) Negative aa) Negative b) Positive c) Negative e) Negative
	0621H a) Negative aa) Negative b) Positive c) Negative e) None
	(continued overleaf)

Charging Methodology Relevant Objective (continued):	0621J a) Negative aa) Negative b) Positive c) Negative e) Negative
	0621K a) Negative aa) Negative b) Positive c) Negative e) Negative
	0621L a) Negative aa) Negative b) positive c) Negative e) Negative

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

Standard Relevant Objectives and Charging Relevant Objectives

All proposals make a positive contribution to at least one of the relevant objectives listed above but this is countered by most of the proposals having a negative impact on some of the other relevant objectives.

It is usually difficult to give weights to the relative importance of the objectives but for this set of proposals we consider that the following criteria are of greatest significance and provide the most crucial test for comparing the 11 proposals under consideration:

- compliance with the Regulation (standard RO g and charging RO e);
- securing effective competition (standard RO d); and
- the provision of cost-reflective charges (charging RO a).

We consider each of these three objectives in turn below;

Compliance with the Regulation - Standard Relevant Objective g) and Charging Relevant Objective e)

All proposals contain improvements over the current charging methodology in respect of compliance with the Regulation and the EU Tariff network code but some achieve this more extensively than others.

Many of the proposals contain the same solution for meeting certain aspects of the EU Tariff code – for example the level of multiplier for short-term firm capacity prices and the level of discount for short-term interruptible capacity.

All but one of the proposals promotes a form of Capacity Weighted Distance (CWD) reference price methodology. Proposal 0621J argues for a postage stamp methodology but this approach is not suitable for a network that still has new demands for capacity - and we continue to see examples of such requests for both entry and exit capacity. Therefore, a CWD methodology is to be preferred to postage stamp as it provides locational price signals using capacity and distance as the underlying cost drivers. A postage stamp methodology does not therefore meet the requirement of Article 7 paragraph (b) of the Tariff network code which states that the methodology should take *“into account the actual costs incurred for the provision of transmission services considering the level of complexity of the transmission network”*

Probably one of the most contentious subjects is how to treat existing entry capacity contracts and how Article 35 of the EU Tariff network code (TAR NC) should be implemented. Most proposals do not maintain the status quo charging arrangements for these contracts when it comes to the levying of Transmission Services Revenue Recovery charges during the enduring period, in that they apply them as capacity, not commodity charges. This is akin to the levying of floating capacity charges. Proposals 0621B, 0621C and 0621E are different in this respect in that they generally apply commodity Transmission Revenue Recovery charges although 0621B and 0621E do not provide such protection at Interconnection Points (IPs). Proposal 0621H would not apply capacity-based revenue recovery charges at IPs or non-IPs but does not compensate for this by levying commodity-based charges. This would result in an unjustifiable, and likely material, distortion between charges for existing and new capacity. Proposal 0621C maintains the status quo at IPs and non-IPs and TAR NC Article 35 explicitly provides for this fair and reasonable outcome.

Therefore, with reference to Standard Relevant Objective g) and charging Relevant Objective e), Proposal 0621C best meets the requirements. Proposals 0621B and 0621C are better and more rounded than the remaining proposals. Proposal 0621H seeks to protect existing contracts from capacity-based revenue recovery charges but arguably it would result in charges that provide protection beyond the expected level foreseen in TAR NC Article 35.

Securing Effective Competition – Standard Relevant Objective d)

Apart from proposal 0621C, all proposals will result in discriminatory treatment of existing entry capacity contracts where capacity-based Transmission Services Revenue Recovery charges would apply. In the case of proposals 0621B and 0621E the level of discrimination is not so great as these proposals promote commodity-based charges at non-IPs. Nevertheless, existing contracts at IPs will have capacity-based charges and this leads to different exposures between IPs and non-IPs that is not justifiable. Capacity-based charges cannot be avoided but commodity-based ones can. Proposal 0621C promotes commodity-based revenue recovery charges at all entry points in respect of existing contracts and will provide for more equitable treatment for gas shippers in terms of IPs versus non-IPs and new capacity versus existing capacity.

Proposal 0621H overly protects existing capacity contracts as we have already mentioned.

All other proposals result in a far worse outcome in their treatment of existing capacity contracts and will load significantly more unavoidable capacity cost on to them. We recognise that there will be differences between capacity reserve prices for new and existing contracts, especially in the enduring period, but purchasers of new capacity can profile their purchases whereas existing capacity holders are completely fettered. Therefore, new purchasers have a choice, but existing contract holders do not. This would result in an unfair outcome for existing contract holders and would not be conducive to promoting effective competition.

From a competition perspective, we do not support proposals 0621F or 0621K as the former does not provide evidence to justify the storage-based capacity discounts at bidirectional IPs whilst the latter seeks to discriminate in favour of storage facilities with a 100% discount on off-peak capacity.

We therefore conclude that proposal 0621C provides a fair and balanced outcome against this relevant objective. Proposals 0621B and 0621E partially achieve this objective, but all other proposals fall well short.

Cost-Reflectivity – charging relevant objective a)

We have already made some reference to cost-reflectivity when comparing a CWD reference price methodology with one based on postage stamp, i.e. the latter does not provide for locational price signals when there remains a need to provide for such signals for a network that still has demand for new access. A CWD methodology does provide some locational price signals but not to the extent as under the current LRMC-based charging methodology. With gas demand on the GB system following a downward trend the current methodology, which was developed at a time when the network was expected to grow significantly, is likely to provide more extreme variations in capacity prices that may not correlate well with the current requirements of existing and new system users. The instability in exit capacity prices and the reliance on high TO commodity charges for revenue recovery have raised major questions over its adequacy and the extent to which it results in charges that are cost-reflective.

CWD is a cost-allocation methodology but one that does provide for some locational signals with prices. It results in less extreme variations in prices across the network and more predictable charges. However, it does throw up some anomalies where the model results in high exit prices for sites located close to some entry points. This might be improved on had there been time to consider realistic flows through the network to limit some of the extreme capacity weighted distances the methodology throws up, e.g. arguably exit points in south west GB should not be associated with flows of gas from the northern-most St. Fergus entry point. However, the development workgroup had insufficient time to assess such an approach.

One mitigating factor is the provision of the optional charge – this is an effective means of addressing some of the CWD anomalies for direct offtakes from the network and must therefore be considered an important part of the overall reference price methodology.

Overall, therefore, a CWD approach with optional charge provides a reasonably cost-reflective outcome but we recognise further improvements can be made. For this reason, we can look favourably against this criterion for all proposals except 0621D that provides no optional charge solution and 0621J that promotes a postage stamp methodology.

Summary

Based on our assessment against the above 3 critical relevant objectives, we conclude that:

- (a) We support proposal 0621C,
- (b) We provide qualified support for proposals 0621B and 0621E,
- (c) We restrict ourselves to comments, neither supporting or opposing, proposals 0621, 0621A, 0621H, and 0621L.
- (d) We oppose proposals 0621D, 0621F, 0621J and 0621K.

Below we offer some further comments on the individual proposals.

0621

Proposal 0621 has 3 major shortcomings:

- **it does not fully comply with Article 35 of the European Tariff network code (TAR NC)** in that it penalises existing entry capacity contracts with capacity-based revenue recovery charges at Interconnection Points (IPs) in the transition period and at all entry points in the enduring period. The effect is to levy floating capacity charges on capacity contracts that TAR NC explicitly protects from such treatment;
- **it does not provide an optional charge solution in the enduring period.** The development of a new charging methodology should not cut corners if it is intended to provide a holistic and forward-looking solution. The setting of optional charges is a complex and keenly debated topic but proposal 0621 will simply park a solution for the enduring period pending some further industry development without any guarantee that an enduring solution will be provided;
- **capacity discounts for Storage Facilities are inadequate and not properly justified.** The 50% discount provided in proposal 0621 is simply the mandatory minimum required by the TAR NC and no attempt has been made, as part of the proposal, to assess whether this is the right level. Any other discount in above 50% could be equally justified on such a basis.

Treatment of Existing Contracts

The first of these shortcomings is prejudicial to enhancing competition in gas shipping and supply in that it directly undermines existing long-term capacity contracts that were established under existing terms and conditions and in good faith. All shippers active in the market have had an equal opportunity to compete for long-term entry capacity on transparent terms that were, when purchased, assumed to be enduring. These terms also applied to the application of a flow-based revenue recovery charge (the TO commodity charge). Proposal 0621 will now amend the terms of the contract with respect to the transmission services revenue recovery charge and this will be to the economic disadvantage of those shippers that have procured such capacity – had the proposals been known at the time of the original capacity auctions then shippers would have factored this in to their booking strategy and bidding pricing.

Consequently, in the absence of an option to relinquish partially or fully the capacity acquired, the result will be to distort the ability to compete in favour of those shippers who typically opt to purchase short-term capacity and have not taken long term commitments. The effect of levying a capacity-based revenue recovery charge on existing contracts will be to apply a floating capacity charge to them. This outcome is unfair and unjustified. It is our understanding that is not permitted by Article 35 of the TAR NC.

Article 35 of TAR NC explicitly requires that the levels of transmission tariffs resulting from contracts or capacity bookings concluded before 6 April 2017 should not be affected, except for indexation.

This can only be interpreted to consider **the entirety** of the existing contract that has been agreed, i.e. as a package of **capacity and commodity** charges. Proposal 0621 therefore does not comply with Article 35 of the TAR NC.

Optional Charges

The omission of an enduring solution for Optional Charges is a retrograde step and, notwithstanding there may be an intention to develop a solution in due course, the current proposal does not in this respect provide an appropriate enhancement to optional charge arrangements. The Capacity Weighted Distance (CWD) basis for setting charges has its shortcomings and there is evidence that it can produce counter-intuitive charges, i.e. high exit capacity charges at exit points located close to entry points. The inclusion of an Optional Charge helps to circumvent this problem for directly connected loads to the NTS and must be regarded as an enhancement to the overall cost-reflectivity of the charging methodology. Therefore, the omission of an enduring Optional Charge solution has a negative impact on the cost-reflectivity of the proposed methodology.

There is a different treatment for Optional Charges at IPs and non-IPs that is potentially discriminatory. This could have a negative impact on facilitating fair competition in gas shipping, supply and pricing and will not be conducive to encouraging cross-border flows.

We also have a major difficulty in accepting the arbitrary Optional Charge distance cap for the transition period. The Proposer initially set the cap at 50km without any justification for it. Subsequently, the cap was raised to 60km so that some existing Optional Charge arrangements would not “just miss out”. So, there has been no objective rationale or assessment behind this aspect of the proposal. The arbitrary cap ignores the fact that there already exist options for gas to avoid usage of the NTS over very long distances. For example, the Offshore SEAL pipeline runs from the northern North Sea to the south with options to deliver gas at either Bacton or directly into Interconnector UK via the SILK pipeline. The shortest offshore route for delivering the gas to the NTS would have been to connect to one of the north-east entry terminals. Instead, the decision was taken to either deliver gas to the NTS at the Bacton entry terminal, where entry charges have been relatively cheap, or to avoid the NTS altogether. The example of the SEAL pipeline would suggest that Optional Charge distances greater than 200km are realistic and that there is a need to consider alternative transportation options, such as offshore delivery arrangements, in a more integrated and less parochial way.

We understand that the economics of an NTS by-pass pipeline will typically deteriorate with increased distance, but there is no rational, cost-reflective basis for proposing an optional charging ‘cliff-edge’ at 60 km or any other arbitrary distance. This point is supported by economic fundamentals and clearly illustrated by the SEAL example mentioned above.

We note that the 60km distance cap will not permit the adoption of an Optional Charge for the Moffat exit point. This will prejudice the cost of transporting gas to the Irish markets and the Isle of Man and is therefore, in its offhand and arbitrary way, entirely not consistent with encouraging cross-border gas flows. This is a significant and important retrograde step from the methodology in use today.

Finally, the proposal does not propose a full Optional Charge methodology for inclusion in the UNC. This is a major omission that cannot be justified. If the Optional Charge is to be considered an integral part of the new charging arrangements, as we believe it should, then the method employed to derive Optional Charges should form part of the UNC because this would provide for greater transparency and appropriate future governance.

Storage Facilities

We are concerned about the future viability of NTS storage facilities that play an important role in providing market participants options for the efficient procurement and disposal of gas. Proposal 0621 adopts the minimum discount to capacity mandated under the TAR NC and does not provide any justification for this. We are much more convinced by the arguments proffered by gas storage operators who have calculated that an 86% discount is necessary to sustain them economically. Their analysis essentially treats storage facilities as if they were a form of NTS linepack and from a transportation charging perspective this is reasonable: the 86% discount will help to avoid any double-charging for gas that is temporarily stored and which does not impose any additional cost on the transportation network. By setting the discount at too low a level proposal 0621 will not provide for an efficient use of storage facilities and will therefore have a negative impact on the efficient utilisation and development of the transportation system, i.e. without storage facilities there may be a need for National Grid Gas to make further investment in the NTS to ensure that peak demand can be readily met. Such investment would be less efficient and have a much less immediate impact than retaining current storage facilities and in encouraging new storage facilities to be developed. Storage also plays an important role in providing flexibility to meet within-day changes in demand and can be accessed as a source of operating margins gas to help the system operator manage transient supply/ demand issues within the gas day.

We also disagree with the proposal to apply Transmission Services Revenue Recovery charges to new system capacity purchases at storage facilities in the enduring period.

0621A

The comments we have made above for Proposal 0621 in respect of Existing Contracts and the Optional Charge also apply to this proposal 0621A and explain why we do not support it.

Proposal 0621A is an improvement on proposal 0621 in the way that it seeks to provide a more effective, and justifiable, discount for system capacity at storage facilities. Nevertheless, overall the proposal has major deficiencies in terms of TAR NC compliance and providing for fair and effective competition in gas shipping and supply.

0621B

Other than proposal 0621C, and to a lesser extent proposal 0621E, proposal 0621B comes closest to providing a properly integrated charging methodology. It differs from all other proposals in that it does not distinguish between transition and enduring periods in its approach. Also, it seeks to retain, in general, flow-based Transmission Revenue Recovery Charges except at IPs where they will be capacity-based. This proposal therefore has merit in that it would provide a good basis for furthering some of the code and charging relevant objectives. However, it contains some major drawbacks that we cannot support.

Treatment of Existing Contracts at IPs

Proposal 0621B falls short in its application of capacity-based Transmission Services Revenue Recovery charges at IPs regardless of whether the capacity has been classified as Existing or Non-Existing. We understand that the TAR NC does not generally permit the use of flow-based revenue recovery charges at IPs but Article 35 of the TAR NC provides a specific exception to this rule in respect of Existing Contracts, such contracts comprising of both capacity and commodity charges. We therefore firmly disagree with the approach taken in the 0621B proposal from a regulatory compliance perspective.

The approach to levying Transmission Services Revenue Recovery charges under proposal 0621B also leads to the discriminatory treatment of Existing contracts at IPs and non-IPs, i.e. the form of charge will be capacity-based at IPs but will be commodity-based at non-IPs. This immediately disadvantages holders of existing contract capacity at IPs in that they cannot avoid the revenue recovery charge whereas those holding existing capacity at non-IPs can avoid it by not flowing gas against it.

This outcome is made significantly worse by proposal 0621B basing its Forecasted Contracted Capacity values on obligated capacity levels. This will result in relatively low capacity reserve prices but at the expense of high Transmission Services Revenue Recovery charges. The effect will be to exacerbate the unreasonable treatment of Existing contracts at IPs in that they will unfairly attract a disproportionately high and unavoidable Transmission Services Revenue Recovery charge.

Optional Charges

The comments provided for proposal 0621 also apply here except that we note that an enduring solution is provided for under 0621B.

0621C

This is the only proposal that we fully support, having developed it in the light of the significant shortcomings we identified with proposals 0621, 0621A and 0621B. None of the subsequent alternative proposals that were raised sufficiently addressed our concerns and we therefore maintained this proposal as a more compliant and more complete solution.

The solution shares much in common with proposal 0621 and some of the other alternatives. But it does contain some significant differences that markedly distinguish it from all other solutions.

Optional Charges

Proposal 0621C is unique in that it recommends a completely new and robust enduring approach to setting optional charges. The approach is closely tied with the underlying basis for apportioning transportation costs under the CWD methodology and the derived Optional Capacity charges are therefore set on a basis that is logical and consistent with the approach taken to the setting of capacity reserve prices. The approach is therefore an integrated one.

The methodology for the derivation and application of Optional Capacity charges is clearly explained and will be contained within the UNC. This is the only proposal under consideration that will provide such transparency and result in acceptable governance.

The proposal does not rely on the setting of an artificial and arbitrary distance cap. The setting of an arbitrary cap under most alternative solutions (proposal 0621D does not provide for Optional Charges) will automatically discriminate against some existing and potentially prospective optional charge arrangements. Most notably, this modification 0621C is the only proposal that will enable shippers to utilise the Optional Charge for delivery of gas to the Moffat exit point and is therefore the only proposal that, in terms of setting optional charges, seeks to better facilitate the efficient delivery of gas to the Irish markets and the Isle of Man.

The Optional Charge solution under this proposal is also enduring and it includes an adjustment to ensure a smooth cutover from the transition to enduring period when, for the latter, higher capacity reserve prices will be set under the CWD methodology.

Existing Contracts

Proposal 0621C provides a solution for existing contracts that is compliant with the TAR NC and results in charging arrangements that maintain the status quo. Article 35 of the TAR NC states that the Regulation **“shall not affect the levels of transmission tariffs resulting from contracts or capacity bookings concluded before 6 April 2017 where such contracts or capacity bookings foresee no change in the levels of the capacity- and/or commodity-based transmission tariffs”**. The current charging methodology provides for fixed capacity charges at entry points coupled with TO commodity charges to help National Grid recover their allowed revenue. This form of contract is maintained under proposal 0621C and it is to apply in the same way at IPs as it will to non-IPs. This ensures a non-discriminatory treatment for existing contracts and permits the collection of Transmission Services Revenue Recovery charges at IPs via flow-based charges only under these circumstances and as prescribed by Article 35 of the TAR NC.

The proposed solution:

- is fair in that it will provide a means for National Grid to collect some revenue under-recovery amounts from existing contracts at IPs via a charging structure that remains the same as when shippers purchased the existing contract entry capacity;
- does not penalise shippers holding existing contract capacity with additional capacity costs that were wholly unexpected when the capacity was purchased, noting that such shippers have no options available to return such capacity to National Grid should the structure of the transportation charges be changed; and
- provides for the same treatment at IPs and non-IPs.

Most other of the proposals under consideration here do not provide adequate protection for existing contracts and are not compliant with Article 35 of the TAR NC. Proposal 0621H proposes no Transmission Services Revenue Recovery charge in respect of existing contracts at either IPs or non-IPs but this does not provide for an equitable spread of costs across shippers. Proposal 0621C strikes the right balance. Proposal 0621L would generate relatively high Transmission Services Revenue Recovery charges and this would result in even less-equitable treatment for existing contracts.

Holistic Solution

Of the alternative solutions under consideration, proposal 0621C provides the most balanced, integrated and enduring methodology.

We believe that the CWD approach is to be preferred to the Postage Stamp approach being promoted by proposal 0621J. The Postage Stamp approach levies a flat entry capacity reserve charge and flat exit capacity reserve charge on all entry and exit system points. It might be argued that this is sensible and justifiable for a network in which demand for gas continues to fall over time. However, while the overall level of demand may be falling there remains new demand for gas and capacity at certain points on the system, as evidenced by a recent flurry of PARCA applications. Therefore, it is appropriate and justifiable to retain a degree of locational price signal but the Postage Stamp approach does not cater for this. On the other hand, the CWD approach does provide locational price signals but not to the relatively extreme extent as under the current LRMC-based charging methodology which is more relevant to a network that is expected to experience more extensive future growth.

CWD is therefore to be preferred to Postage Stamp. Although CWD can be regarded as a cost allocation method and can be regarded as being less cost-reflective than the current LRMC-based methodology, it does factor-in network distances and capacities when making the cost allocation so that these cost-drivers play an important part when deriving capacity reference prices. What differentiates proposal 0621C from all other CWD-based proposals is that it integrates an enduring, non-discriminatory Optional Charge solution that helps to eliminate counter-intuitive charges at proximate entry and directly connected system offtakes.

Proposal 0621C agrees with the analysis that proposes an 86% discount on system capacity at storage facilities. It is important that these facilities remain economically viable and the level of discount proposed has been justified by an assessment carried out and published by gas storage operators.

All 11 alternative proposals promote the same solution for short-term firm capacity prices and for the pricing of interruptible capacity. Arguably, a small discount on short-term firm capacity should be provided to better reflect the short run marginal cost of capacity but it is difficult to objectively set such a level. Certainly, the shift from the current situation where firm entry capacity can be purchased for free is entirely defensible. The discount available for interruptible capacity is significantly reduced under all proposals, compared with the current methodology, and it is again difficult to assess what a reasonable level of discount ought to be. Notwithstanding these possible shortcomings, the new suite of proposals for short duration firm and interruptible capacity is much more credible than under the current methodology and should help to reduce National Grid's reliance on recovering their allowed revenues via excessively high Transmission Services Revenue Recovery charges.

Conclusion

In summary, proposal 0621C shares much in common with many of the other proposals being considered but it provides the most balanced, fair and forward-looking solution of the lot. It scores well against the furthering of many of the standard relevant objectives and charging relevant objectives.

0621D

The comments made above for proposal 0621 in respect of the treatment of existing contracts and storage facilities also apply here and should help to explain some of the reasons for why we oppose this proposal 0621D.

This proposal attempts to reduce capacity prices at the extremes of the gas system by employing a square root distance in the underlying CWD methodology. This would appear to

have the effect of pushing charges slightly in the direction of those that would be derived via a Postage Stamp approach. However, the intention is more than negated by the proposal to completely remove the Optional Charge from the methodology.

As we have already stated, the Optional Charge provides a means for helping to address counterintuitive charges at proximate entry and exit points. It also brings other benefits such as helping to encourage greater use of the pipeline system by attracting gas that might otherwise be transported via alternative pipelines or gas that might be diverted to other markets and therefore not made available to GB consumers. The Optional Charge can also facilitate cross border/ cross IP gas flows.

We see no benefit to the GB market in removing the Optional Charge from the methodology; in fact, such removal would be detrimental and lead to a less cost-reflective outcome under a CWD reference price methodology.

We also note that the proposer, a Distribution Network Owner, employs a form of optional charge for its own network as do other DNOs in GB.

0621E

The objections we have raised against proposal 0621 also apply to this proposal, i.e. inappropriate treatment of existing contracts, an unjustified distance cap for the Optional Charge, and an unsubstantiated discount to system capacity prices at storage facilities.

We understand the argument for extending the transition period because of implications for the electricity market but the proposal is one-sided in that the extended transition period would only apply to system exit points. We are of the view that entry and exit should be treated in the same way regarding timescales and dates for transition, and therefore the proposal would have been more equitable had this approach been taken.

However, the proposal is similar to 0621B in that it would maintain the status quo charging basis for existing capacity contracts but only at non-IPs.

0621F

We understand and agree with the need to ensure that cross-border gas flows, or flows across IPs, are facilitated and unimpeded by any direct or indirect means so that effective wider market interactions can be optimised. So, there may be some arguments to support a discount to capacity prices at IPs but a sufficiently convincing case has not been provided by this proposal.

As with many of the other alternative proposals our 3 main objections to proposal 0621 apply to this proposal 0621F as well.

0621H

We acknowledge and agree with many of the concerns expressed about the treatment of existing contract capacity (refer to our comments above under 0621 and 0621C) but the proposed solution, to not apply any Transmission Services Revenue Recovery charges against these contracts in the enduring period, is not sufficiently balanced. We are of the view that all gas accessing the GB market in the new regime should contribute to revenue under-recovery corrections but this proposal does not provide for that.

Additionally, our concerns with the treatment of the Optional Charge and discounts for storage facilities under proposal 0621 also apply to this proposal.

0621J

As with proposal 0621, we find fault with this proposal 0621J in its intended treatment of existing contracts and in the imposition of an arbitrary distance cap for the Optional Charge. Please refer to the comments we make under proposals 0621 and 0621C in respect of this.

This is the only proposal to deviate from a CWD-based charging model. The Postage Stamp approach might be economically justifiable for a pipeline system where there is surplus capacity and no, or negligible, demand for new capacity. However, as we have argued when describing our support of proposal 0621C, there remains demand for capacity at various locations on the network and this justifies the retention of a degree of locational price signal that is absent from a Postage Stamp approach. To better deliver against the Relevant Objectives, a charging methodology should be robust and promote efficient use and development of the pipeline system, over time. Especially in the medium-long term, there are likely to be points on the system where additional capacity is required (e.g. for new gas-fired power stations, gas storage facilities or incremental LNG inflows) as UKCS gas production continues to fall. Therefore, we do not consider the Postage Stamp model to be sufficiently cost-reflective.

0621K

As with proposal 0621, we find fault with this proposal 0621K in its intended treatment of existing contracts and in the imposition of an arbitrary distance cap for the Optional Charge. Please refer to the comments we make under proposals 0621 and 0621C in respect of this.

Proposal 0621K's distinguishing feature is that it seeks a 100% discount on interruptible/ off-peak exit capacity but only at storage facilities. We support an 86% discount on firm system capacity at storage sites and consider this to be sufficient to help sustain them. However, as we have stated above, we are of the view that all gas utilising the pipeline system should contribute to National Grid's revenue recovery and we therefore do not support a 100% discount. Furthermore, the proposal is discriminatory in that it only seeks to apply the 100% off-peak discount to storage facilities.

Having high levels of capacity discounts raises the question of whether user commitment requirements are appropriate – do they inhibit the development of new entry or exit points and do they adequately protect the wider shipper community from costs brought to bear by third parties? What is the optimum balance between the two? This is something we believe should be explored as a separate, but related exercise. The current user commitment regime for entry capacity means that shippers cannot hand back long-term entry capacity to National Grid, unlike for exit capacity, and this is a major factor contributing to the question of how to fairly treat existing entry contracts under the new charging arrangements.

0621L

As with proposal 0621, we find fault with this proposal 0621L in its intended treatment of existing contracts and in the imposition of an arbitrary distance cap for the Optional Charge. Please refer to the comments we make under proposals 0621 and 0621C in respect of this.

The treatment of existing contracts is made worse under proposal 0621L. This is because it will generate lower capacity reserve prices and will favour higher Transmission Services Revenue Recovery charges.

Some arguments have been made that there is likely to be a large difference in capacity prices between existing and new entry capacity in the enduring period. The analysis conducted seems to support this but it must be emphatically remembered that purchasers of new capacity can choose the products they require and profile their capacity to optimise their costs; existing capacity holders have no choice but to soak up any capacity charges that are levied on them. So, the issue needs to be considered in a more rounded manner – it's not just about price differences. Having said that, user commitment requirements for new projects should be reviewed as the level of capacity charges might deter new investment.

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

Implementation should be in sufficient time to ensure timely compliance with the TAR NC, i.e. by 31 May 2019. Ideally, the proposal should be implemented no later than 6 months before 1 October 2019 to provide system users with time to plan their requirements and capacity booking strategies.

We are very concerned that the possible implementation of one of the 0636 modification proposals from 1 October 2018 (that seek to amend the optional commodity charge) will imperil GB's ability to implement TAR NC by 31 May 2019. If one of these proposals is implemented then it will be necessary for the 0621 proposals to be sent back to workgroup so that they can be re-assessed against a new UNC baseline. Even with a flexible approach from proposers, workgroup members, the Joint Office, the UNC Panel and Ofgem such an eventuality would set back the work by several months.

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

For each of the proposals we expect there to be some administration, IS and training costs in preparing for the transition to the new charging regime.

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

We have not had sufficient time to assess the legal text for all proposals.

Modification Panel Members have requested that the following questions are addressed:
Please specify which Modification your views relate to.

1. *Do you believe there is specific issues that should be considered by Ofgem's Regulatory Impact Assessment?*

A comprehensive list of areas that should be explored by Ofgem is set out in section 10 of Part 1 of the Draft Workgroup Report and these should be carefully considered by Ofgem.

It would be helpful if Ofgem also considered whether changes should be made to the capacity products being offered by National Grid – how they are structured; their availability and duration; and whether the current user commitment regime is likely to promote efficiency and protection for shippers in the longer term.

Ofgem requested that the following questions be included as part of the consultation. Panel agreed to include these:

- 2. The rationale in the report for having an interim period and using the obligated capacity as the Forecasted Contracted Capacity (FCC) is to avoid significant changes to charges and have a period to understand how booking behaviour changes. How does this compare to having two structural changes to charges (one at the start of the interim period and another at the enduring period)?*

Many significant changes are being made to the charging methodology under each of the alternative proposals under consideration and it is very difficult to predict what effects they will have on the GB market. Taking a single change in isolation it may be possible to predict what the outcome might be but taken in combination with other changes the task is extremely challenging.

The prospect of introducing the full, enduring range of change in a single step would therefore make it difficult for shippers and other affected stakeholders to fully grasp and prepare for the range of change and to assess the likely effects on their businesses before the new methodology takes effect. What the charging methodology will be is unlikely to be certain until only around 6 months prior to implementation. This provides stakeholders with very little time to plan and react to the changes. Given this background it would be sensible to phase-in the changes and the transition period will provide for this.

If a more capacity-based set of transmission charges is the likely outcome of the current change process then there is a big reliance on the ability of National Grid to accurately forecast contracted capacity levels. Poor forecasting will have a major detrimental impact on the setting of appropriate capacity charges and, as the forecasting mechanism would have to be adjusted over time to compensate for this, there would be a period of uncertainty and unpredictability on what future charges would look like. It is much more sensible to allow National Grid some time to develop, test and consult on their forecasting approach and to make use of more up to date and relevant information on shipper booking behavior.

The downside of having a transition period is that the full impact of the wide range of charging changes will take longer to understand but this is outweighed by avoiding a cliff-edge scenario from 1 October 2019. This logic would also apply if there were different structural changes to the charges in the transition and enduring periods.

Our expectation is that whichever of the modification proposals is implemented, there will be continual change to the charging methodology when shortcomings and improvements are identified. There has been very little time available to analyze what the outcomes might be but even if there had it would be challenging to predict what the actual outcomes will be.

The transition period should not be viewed as a soft-landing. It will see a completely new method for the derivation of capacity reserve prices which will have major re-distributional effects, and discounts for short-term firm and interruptible products are being significantly reduced. The change to short-term product pricing ought to result in a reduction in Transmission Services Revenue under-recovery.

The Distribution Networks have highlighted that a more capacity-based regime will result in higher charges passed on to shippers who use their networks. Under most modification proposals this would become most significant in the enduring period. These impacts need to be further explored – are they ubiquitous across all DN entry/exit points and what remedies would be appropriate? Remedies should not be confined to changing the NTS charging methodology but should also explore the booking patterns of the DNs, the range

of products available to them and whether they should be encouraged to manage their own networks differently and to invest in alternative ways of meeting consumer demand.

We therefore conclude that there remains a need for much more on-going assessment and that affording Ofgem and industry some more time to achieve this before implementing a full, enduring solution makes good sense.

3. *What (if any) consequences do you see from 'interim contracts' being allocated at QSEC and AMSEC auctions in 2019 given the timings of these auctions in the UNC and possible date of Ofgem decision on UNC621? What options are there to deal with these consequences and what impact would these options have?*

It is necessary that shippers know how the capacity will be treated before the auctions commence. It may be necessary for a new modification proposal to be raised and implemented before a decision is taken on the 0621 proposals to ensure that the interim capacity concept, or its equivalent, is introduced early and the treatment of the QSEC and AMSEC capacity in the 2019 auctions is made explicit.

4. *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?*

Generally – yes, although we firmly disagree with some interpretations of TAR NC article 35 where proposers seek to levy capacity-based Transmission Services Revenue Recovery charges on existing entry capacity contracts.

5. *In what way do you consider the reference price methodologies proposed (Capacity Weighted Distance (CWD), CWD using square root of distance and Postage Stamp) to be cost reflective and meet the criteria in Article 7 of TAR?*

We have made comments on this subject in our responses on some of the proposals above. Cost-reflectivity is difficult to define and assess, especially in relation to the charges levied by a monopoly provider and in circumstances where the provider will always recover an allowed revenue. CWD is, we believe, a reasonably cost-reflective approach that provides some locational price signals by making reference to system capacities and network distances between entry and exit points. At some future date it may be appropriate to consider a simple postage stamp approach but as there remains demand for new access to the NTS it would not be appropriate to do so today.

6. *The proposals have different combinations of specific capacity discounts for storage sites and bilateral interconnection points. In what way do you consider the different combinations facilitate effective competition between gas shippers and gas suppliers?*

We have provided comments on these topics above. We are unconvinced by the case for storage-related discounts at bidirectional IPs; some form of discount may be required to facilitate cross-border flows but no convincing rationale has yet been provided. We believe that the 86% discount proposed for capacity in respect of storage facilities has been demonstrated via some useful analysis compared with the mandatory minimum level of 50% that has not had any analysis to vindicate it. We do not support a 100% discount for off-peak/ interruptible capacity at storage facilities as contained in one of the proposals as there has been no credible justification for this.

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.*

None identified.

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