

**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**

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<b>Organisation:</b>	Eni Trading & Shipping SpA
<b>Date of Representation:</b>	22 June 2018
<b>Support or oppose implementation?</b>	0621 - Oppose 0621A - Oppose 0621B - Oppose 0621C - Oppose 0621D - Oppose 0621E - Oppose 621F - Oppose 0621H – Support 0621J - Oppose 0621K - Oppose 0621L - Oppose
<b>Expression of Preference:</b>	<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> 0621H

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

**0621H**

Modification proposal 621H has been raised to address serious defects associated with applying a capacity-based Revenue Recovery Charge (RRC) to historical contracts.

To secure effective and fair competition between relevant shippers, historical capacity contract terms need to be honoured when they are transitioned to the new charging regime (which will be radically different from the current regime).

The most significant proposed changes for the new charging regime are the removal of the long-term fixed price capacity contract and the introduction of a fully floating capacity-based RRC. Those changes will cause a significant shift of price risk in the historical capacity contracts because, under the current arrangement, when shippers buy long-term capacity at a fixed price it is National Grid Gas (NGG) that takes the price risk. Furthermore, if shippers opt not to use their booked capacity, they pay no additional charges (neither a further capacity charge nor a RRC, the latter being commodity-based now). The legitimate expectations of these long-term capacity holders was and is that during the course of the contract they will have to pay, on a ship-or-pay basis, only the capacity charge fixed by the contract, while the commodity charge (that responds also to the aim of minimising NGG's under-recovery) shall have to be paid only when and to the extent that they opt to use the booked capacity.

When the floating reference/reserve price is introduced, the long-term price risk will be moved to shippers who purchase capacity, whether or not they chose to use that capacity. This will deter shippers from acquiring long-term capacity and potentially discriminate against new infrastructure projects that are required to acquire long-term capacity to trigger National Transmission System (NTS) investment. This in itself is a significant contract change and a reason why we support the transition period.

However, to fully protect the historical contracts, we proposed that no capacity-based RRC should apply to historical contracts once the new regime is implemented in both the transition and the enduring periods. Importantly, the 621H proposal provides the right solution for Bacton IP capacity that was forcibly re-allocated to the new Bacton IP ASEP in November 2015, in order to comply with CAM requirements. This change in addition to the loss of Bacton capacity fungibility resulted in substantial interference in the property capacity rights of the affected capacity owners in 2015. The existing Bacton IP capacity has been misallocated and it is now stranded. The imposition of additional charges, in the form of capacity-based RRC, will further penalise the holders of this capacity without suitable redress.

With regard to the Reference Price Methodology, acknowledging that there are tensions and trade-offs between various objectives (e.g., it is not possible to achieve full-cost reflectivity in any entry-exit system; however, an absolute cost-reflective tariff for every capacity contract will require a highly complex charging regime), we are in support of the Capacity Weighted Distance (CWD) methodology. It is TAR NC compliant, broadly cost-reflective and provides for a stable and predictable price-setting regime. In addition, because it includes a distance cost-driver, resultant charges provide locational signals. These latter points are not consistent with the Postage Stamp methodology (the implementation of which, however, we do not fiercely object to).

Besides cost reflectivity, another important objective that has to be ensured by transmission tariffs is to avoid any undue discrimination among shippers. Because both long-term capacity

users and short-term capacity users ship across the same gas network, they need to make equitable contributions to the cost of the network. We therefore proposed that short-term discounts in capacity price should be removed. A 100% discount on the price of short-term capacity has been in place for a long time and this has resulted in flight to short-term capacity in GB where the risk of congestion is very low. Large quantities of unsold long-term capacity are rolled over into short-term capacity auctions where it is mostly sold at zero price. This causes a large capacity revenue under-recovery, which is resolved with the application of a high commodity-based RRC. This uniform charge is not cost-reflective, although it is perceived as a fair charge by most of the users because they prefer to pay the same price as everyone else. This results in effective discrimination between long-term and short-term capacity holders because short-term holders are not making an adequate contribution to the historical costs incurred by NGG to deliver the entry capacity. In other words, short-term holders are granted access to a network that is paid for by long-term capacity holders (data published by NGG show that while long-term capacity products represent around 50% of the total booked capacity, their contribution to NGG's revenues amounts to 99.6%). Another problem is that the level of revenue under-recovery has become very high over the years and it affects the way the Optional Commodity Charge (OCC) is used: the higher the RRC Commodity Charge the greater the incentive for the use of discounted OCC that becomes viable over longer distances. On the whole, this charging combination has led to volatile and unpredictable charges.

0621/0621A/0621B/0621C/0621D/0621E/0621F/0621J/0621K/0621L

None of the above-proposed modifications provide a full solution for long-term capacity products and, if they are implemented, then the treatment of the historical capacity holdings in the new regime risks amounting to a serious distortion of competition and at the same time causing the market to become inefficient and uncertain:

- inefficient, because it creates a "two tier" regime for what should be a homogenous product, with certain capacity penalised by the imposition of additional costs; and
- uncertain, because it undermines the sanctity of contract and exposes users to unacceptable levels of regulatory risk. This will undermine any future long-term capacity bookings, or indeed any longer term arrangements (as detailed in the text above), which might be entered into between users and NGG; and shippers being less willing to book long-term capacity in the future would have adverse effects on security of supply.

An approach that distorts the price of entry capacity, and fails to take any mitigating steps to prevent the resultant damage to gas shippers who bought that capacity on a legitimate basis that existing capacity would maintain its fixed price, would be non-compliant at least with Relevant Objective (d), which gives emphasis on efficient and effective competition.

Finally, Mod 621H ensures a proper application of Article 35 of the EU Tariff Code by providing that the capacity price of historical contracts remains unadjusted for the entire duration of the relevant contracts.

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

We support the implementation date of 31 May 2018, compliant with the EU Tariff Code, and with the methodology change taking effect for prices from 1 October 2019. However, given the materiality of these proposals, it would be very helpful to receive a "minded-to" decision of Ofgem's Regulatory Impact assessment by no later than Q3 2018.

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

We cannot make an informed assessment at this stage.

**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.*

Yes.

**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?**

We agree with the list of issues highlighted for consideration in the UNC Workgroup Report Part I. In addition, RIA should review the effect of a capacity-based Revenue Recovery Charge (RRC) on historical capacity contracts in both the transition period and the enduring period.

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)?**

The transition period is necessary to successfully manage significant changes that will be implemented in the new charging regime:

1. a new Reference Price Methodology will be used to calculate capacity prices;
2. the current fixed capacity reserve price will be removed and replaced with the fully floating capacity reserve price; and
3. a 100% discount in the price of short-term capacity will be replaced (no discount for firm capacity and a 10% discount for interruptible capacity).

The values of obligated capacity are known in advance and stable unless there is a licence change. Significant changes in the new regime require a transition period so that both shippers and NGG can adjust to the new charging regime. Setting the FCC at the level of obligated capacity will provide shippers with price transparency and stability in the first two crucial years of the implementation of the new regime.

**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?**

In order to properly manage the transition from the current charging regime to the new regime, it will be necessary to define the price treatment of AMSEC and the QSEC 2019 auctions before these auctions commence. We believe that if the bidding process for these auctions takes place before Ofgem delivers its decision on UNC621 then any allocated capacity in these auctions should be treated as historical capacity. Either way, shippers require certainty ahead of the auctions.

**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?**

In general, modification proposals are broadly compliant while some allowed optional elements have been interpreted to reflect GB circumstances. However, only Mod 621H is fully compliant with Article 35 of the EU Tariff Code, ensuring that no capacity-based RRC will be applied on historical 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?**

As we stated before, due to tensions and trade-offs between various objectives it is difficult to achieve full-cost reflectivity in any entry-exit system; we are in support of the Capacity Weighted Distance (CWD) methodology. It is TAR NC compliant, broadly cost-reflective and provides for a stable and predictable price-setting regime. In addition, because it includes a distance cost-driver, resultant charges provide locational signals. These latter points are not consistent with the Postage Stamp methodology (the implementation of which, however, we do not fiercely object to).

**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 deem that 50% discount for storage is compliant with EU Tariff Code.