

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:	David Mitchell
Organisation:	Scotland Gas Networks and Southern Gas Networks
Date of Representation:	22 nd June 18
Support or oppose implementation?	0621 - Oppose 0621A - Oppose 0621B - Oppose 0621C - Oppose 0621D - Oppose 0621E - Oppose 0621F - Oppose 0621H - Oppose 0621J - Oppose 0621K - Oppose 0621L - Oppose
Expression of Preference:	<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> 0621J raised by RWE

Standard Relevant Objective:

- 0621
 - a) None
 - c) Negative
 - d) Negative
 - g) Negative
- 0621A
 - a) Negative
 - c) Negative
 - d) Negative
 - g) Negative
- 0621B
 - a) Negative
 - c) Negative
 - d) Negative
 - g) Negative
- 0621C
 - a) Negative
 - c) Negative
 - d) Negative
 - g) Negative
- 0621D
 - a) None
 - c) Negative
 - d) Negative
 - g) Negative
- 0621E
 - a) None
 - c) Negative
 - d) Negative
 - g) Negative
- 0621F
 - a) None
 - c) Negative
 - d) Negative
 - g) Negative
- 0621H
 - a) None
 - c) Negative
 - d) Negative
 - g) Negative
- 0621J
 - a) None
 - 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, 0621A, 0621B, 0621C, 0621D, 0621E, 0621F, 0621H, 0621J, 0621K, 0621L a) Negative aa) Negative b) Negative c) Negative e) Negative
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Reason for support/opposition and preference: Please summarise (in one paragraph) the key reason(s)

SGN does not feel that it is able to support any of the modifications.

This is primarily due to the predicted customer impact of the proposals. We also have concerns that neither the CWD model or the postage stamp models are cost reflective.

We have provided further detail in relation to our position as below. Please note that given our opposition to all proposals, we will not be providing individual comments on either the original proposal or the alternates.

Capacity-Weighted Distance Model

Currently Shippers on GDN networks pay exit capacity charges generated by the Long Range Marginal Cost model (LRMC) which is reflective of the actual relationship (distance) between the entry facility and offtake. We consider the current distance calculation used by the LRMC model to be more cost reflective than any of the above proposals, as it is reflective of actual system usage and the operational relationship between entry and exit. As it stands we do not believe that where proposed the CWD model improves on this position.

As an illustration, the table below details the physical point to point distance between the entry facility and the offtake. It also highlights the average distance between the offtake and every entry facility on the basis of the distance calculation which would be used by CWD (excludes capacity weighting).

Illustration of the distance assumption between entry and offtake	
Relationship entry to exit	Point to point distance (km)
St Fergus - Aberdeen	50
Bacton - Hardwick	190
Exit Point	Assumed average distance CWD -no capacity weighting (km)
Each entry point - Aberdeen	611
Each entry point - Hardwick	347
Aberdeen variance actual to CWD notional (km)	561
Hardwick variance actual to CWD notional (km)	157

As illustrated in the table above, the CWD assumes a distance which is used to generate charges for Aberdeen offtake which are 11 times greater than the actual physical distance between the entry facility and offtake. In comparison, the distance for Hardwick offtake is 0.8 greater than the actual physical distance. This demonstrates that the use of CWD creates a greater disconnect between actual system usage for those offtakes located at an extremity in comparison to those which are within the hub of entry facilities in southern and central England. This results in charges which are not cost reflective.

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Furthermore, the CWD model does not recognise the current operational constraints which restrict the flow of gas from entry facilities in the South of England to Scotland offtakes. These constraints physically prevents the hypothetical flow of gas which underpins the CWD, and as such precludes the CWD model from being reflected in reality.

In addition to the physical constraints on the system, we experience a continued drive from NTS to accept reduced pressures from St Fergus. Further information is available in National Grid's 10 year statement, which details these system constraints in section 3.4 "System Capability" https://www.nationalgrid.com/sites/default/files/documents/GTYS%202017_3.pdf

Dynamic operational factors such as the above further impact the physical feasibility of gas flow through the network, and therefore exacerbate the degree to which CWD does not reflect the network.

Cost Reflectivity

SGN does not feel that it has been sufficiently demonstrated that the key elements driving the proposals would result in total charge levels reflecting the bookings made on the system.

SGN's key concern is the impact of the moving basis of Forecast Contracted Capacity (FCC), a single pot for revenue recovery and K. The proposals are making fundamental changes to the charging structure yet little evidence has been provided to demonstrate that the revenue required associated with the booking reflects the actual revenue recovered.

Currently Shippers on GDN networks pay NTS exit commodity charges and exit capacity charges levied by National Grid on a pass-through basis by GDNs.

Certain Modifications propose the cessation of the NTS exit commodity charges to Shippers, with NTS exit revenue instead being recovered through capacity charges as passed through by the GDNs. The impact of this approach will be a significant increase in these capacity charges once the enduring arrangements are in place, yet with little visibility available to the customer as to the source of the charges and relevant increases.

Furthermore, SGN are concerned in relation to the Modifications which propose to utilise peak capacity bookings as the basis of FCC (volume forecast) and uses average flows as the basis for GDN's volumes. This results in a distortion of charges where 80% of the NTS exit capacity will be recovered from GDNs that only account for 50% of the flow (compared on a consistent basis using obligated levels and historical bookings)

Postage Stamp Model

Similarly, we do not consider that a postage stamp model is an improvement upon the current arrangements. Whilst a postage stamp model represents a more equitable arrangement, in that

all customers pay the same, similar to CWD this cannot be described as a cost reflective model given that the model does account for operational entry to the network based on optimised supply and demand, as per the existing LMRC model.

Price Volatility

We have undertaken and published analysis that highlights that the proposed changes are likely to result in exit capacity charge levels which, in the short to medium term, are volatile and would be a significant step change from those produced using the current methodology.

Given that these proposals are a fundamental change from the current methodology we consider there to be a high probability that unquantified factors will impact stability and predictability of charges.

A further issue will be the lack of visibility of the proposed methodology of FCC and the associated charge levels in the enduring period. Little consideration has been given to the timeline to develop the methodology and price levels based on behaviours in the transitional period and how this fits with GDN pricing timelines. As National Grid and GDNs have the same publication deadlines, SGN will have little or no certainty in relation to National Grid's pricing requirements and as such will be required to estimate the costs. This may further introduce volatility into the price-setting process, due to a likely requirement to revise and reconcile these prices once the confirmed NTS position is available.

In developing the Modification proposals, SGN feels that it is worth noting that the challenge and review process has been very limited due to the EU time constraints. As such, there is a risk that any implemented solution may be subject to further challenge and refinement, potentially resulting in further modifications which could add to the price volatility.

Prior to the implementation of DNPC06 in October 2012, National Grid levied Exit Capacity Charges (ECN) directly to shippers. These alternative arrangements resulted in GDN's allowances being adjusted to reflect the NTS costs in respect of the offtakes within the distribution network. The introduction of this GDN charge was considered to facilitate improved cost reflectivity and predictability. The GDN's now levy the charges payable directly to DN shippers on National Grid's behalf with any variance between the set allowance and actual cost being trued-up on a two-year lag. On reviewing the basis on which charge was established, SGN strongly believes that license and/or UNC changes are required to remove/limit the price volatility passed through to customers.

Joint Office of Gas Transporters

The table below illustrates the potential charging impact of 0621 on Exit Capacity Charges (ECN) in Scotland. The table below highlights the step change from the current charge levels as well as the short to medium term volatility. Note that SGN has no control of how these charges are passed on to end users.

Customer Impacts

Through-out development of the modification proposals, SGN has flagged the potential customer impact associated with the new arrangements.

We also foresee that we will have difficulty in messaging these impacts to customers when the proposals are signposting a message of improved stability. SGN feels that insufficient consideration has been given to the processes/timelines required to support the introduction of the new methodology and therefore the associated pricing volatility.

Should Mod 621 or one of its alternates be implemented then SGN believes that Ofgem has a role to play in communicating the substantial increases in costs faced by consumers and businesses, especially those in Scotland. This message will be complex given the substantial proportion of the UK gas supply being beached in Scotland.

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

The implementation lead times of the preferred modification needs to be in place by October 2019 to ensure compliance with the EU Tariff Code.

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

SGN does not expect any system costs from these modifications if implemented however we may experience funding impacts due to the cost recovery lag.

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 believe that the legal text will deliver the intent of the solutions.

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?*

SGN believes that Ofgem's Regulatory Impact Assessment needs to primarily focus on how the proposals geographically impact end users, demonstrate cost reflectivity and introduce improved stability. They should also focus on the recovery of the charges and which party is best placed to recover these from Shippers.

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)?*

SGN has highlighted its concerns in the main body of this response giving our view as to the lack of cost reflectivity and the impact of introducing volatility due to the changing basis of the FCC from transitional through to the enduring period. Due to the unknown nature of booking behavior and lack of certainty of the methodology used to derive the FCC in the enduring period SGN believes that this is likely that exit capacity charges passed on to our customers will become more volatile.

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?*

SGN does not enter into QSEC and AMSEC auctions hence we are unable to provide a view on this process.

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?*

No Comment

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?*

SGN does not believe that the CWD model is cost reflective given the configuration and operation of the physical network not being able to deliver gas to all areas of the network. We would ask Ofgem to consider the example that we have provided in this response whereby the CWD model assumes that Aberdeen can get its supply from any Offtake in the UK hence the CWD is 611km instead of the 50km from St Fergus which delivers its gas.

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?*

As above we will not make comment on specific proposals.

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

We do not have any further analysis to add to this representation.