

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:	Paul Youngman
Organisation:	Drax
Date of Representation:	22 June 2018
Support or oppose implementation?	0621 - Comments 0621A - Comments 0621B - Qualified Support 0621C - Qualified Support 0621D - Oppose 0621E - Support 0621F - Oppose 0621H - Comments 0621J - Oppose 0621K - Comments 0621L - Comments
Expression of Preference:	0621E

Standard Relevant Objective:

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

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

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

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

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

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

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

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

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

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

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

**Charging Methodology
Relevant Objective:**

- 0621
a) Negative
aa) Negative
b) Positive
c) Negative
e) None

- 0621A
a) Negative
aa) Negative
b) Positive
c) Negative
e) None

- 0621B
a) Negative
aa) Positive
b) Positive
c) Negative
e) None

- 0621C
a) Positive
aa) Negative
b) Positive
c) Negative
e) None

- 0621D
a) Negative
aa) Negative
b) Negative
c) Negative
e) None

- 0621E
a) Negative
aa) Positive
b) Positive
c) Negative
e) None

- 0621F
a) Negative
aa) Negative
b) Negative
c) Negative
e) None

- 0621H
a) Negative
aa) Negative
b) Negative
c) Negative
e) None

(continued overleaf)

**Charging Methodology
Relevant Objective
(continued):**

0621J
a) Negative
aa) Positive
b) Positive
c) Negative
e) None

0621K
a) Negative
aa) Negative
b) Negative
c) Negative
e) None

0621L
a) Negative
aa) Positive
b) Positive
c) Negative
e) None

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

General points – Models and preferences against relevant objectives

As a supplier of gas to the SME market and developer of gas powered generation Drax group companies have maintained a keen interest in the development of the Gas charging arrangements.

The focus of workgroup development was to reach a constructive consensus on the most appropriate model to satisfy EU Tariff Code¹ and align with the policy direction issued by Ofgem². The EU Tariff Code describes a methodology as a counterfactual charging model, but does not require it to be implemented. After the issuing of Ofgems policy letter in March 2017 workgroup development of options derived from Long Range Marginal Cost model (LRMC) were halted.

Within these boundaries two models have been proposed to be assessed as an alternative to the current arrangements (LRMC). These are the Capacity Weighted Distance Model (CWD) proposed by National Grid (and nine alternates) and the Postage Stamp model proposed by RWE. Both these methods are Cost Recovery rather than Cost Reflective methods of recovering transmission charges.

The Postage Stamp method by definition is a cost recovery mechanism. The CWD model allocates costs based on average distance between exit and entry points and capacity. A distributional analysis of the CWD model highlights that some exit points located relatively close to entry points have higher charges than exit points located further from an entry point. This is

¹ (EU) 2017/460 establishing a network code on harmonised transmission tariff structures for gas. <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32017R0460>

² Ofgem policy direction and presentation from NTSCMF meeting of 06/03/2017 <https://www.gasgovernance.co.uk/sites/default/files/ggf/Policy%20view%20update%20letter%20NN.pdf>

counterintuitive and not cost reflective. As such neither proposal satisfies Relevant Objective (d) or Charging Relevant Objective (aa). It is recognised that both methods may lead to more predictable and transparent charges and may more efficiently discharge the licensee's obligations Relevant Objective (c). This could also marginally benefit competition, however both models introduce distortions of competition between incumbent and new capacity holders against Relevant Objective (d) and Relevant Charging objective (a) and (aa). Against the EU compliance neither model is either cost reflective or applies relevant flow scenarios in determining tariffs (art 8). It is also noted that all proposals are not compliant with the EU Cost Allocation assessment either in the Transition or Enduring period (art 5) – Relevant objective (g) and Relevant Charging Objective (e)

Within that context, of the alternates proposed we offer qualified support to both 621B and 621C and support 621E. Both 621B and 621C have a potentially less negative impact on competition than other alternative modifications as both offer potential mitigating measures for existing and future Transmission connected customers. We also believe that both options offer a more compliant basis upon which to base future charging arrangements. We support and agree with the proposer of 0621E that more time could be given to ensure an accurate enduring determination of FCC by increasing the transition period to three years. This would enable sufficient time to understand any changes in booking behaviour and flows, and assess the impact of these changes on the electricity capacity market process.

0621

This proposal and the model developed by National Grid has formed the basis all but one of the alternate modifications. Many of the points highlighted in these comments are applicable to all CWD alternatives.

The proposal is a cost recovery mechanism and not a cost reflective method of recovering transmission charges. It does not consider relevant flow scenarios as envisaged in TAR Art 8 and there is no clear method or process determined to establish enduring FCC values after the transition period.

We do accept that the CWD model may produce a more consistent and stable year to year charging basis than has been the case historically under LRMC. However, this is dependent on how market participants alter their capacity booking and behaviour in the interim and enduring period. We think this will change markedly and could lead to instability in future. Additionally, this also creates an uneven playing field between existing capacity holders and new entrants that may have consequential impacts on competition in the Electricity Capacity Market.

We have concerns that the CWD model leads to an increase of the costs for new Transmission Connected Generation. This is as a consequence of the increased costs for capacity and the reflection of this within the PARCA Security Amount³. The current charge for this is 0.0098 p/kWh/day.⁴ Under 0621 and the majority of alternates this increases to 0.0201 p/kWh/day in the enduring period.

Given the large differentials in capacity charges at exit points from existing arrangements it could be considered that incumbent capacity holders may have an unfair advantage over new market entrants as current capacity holders will be able to reduce bookings to reflect actual flows,

³ UNC Section Y para 46

⁴ National Grid Gas Transmission transportation statement March 2018 p11
https://www.gasgovernance.co.uk/sites/default/files/ggf/book/2018-03/April%202018%20Transportation%20statement_0.pdf

whereas new entrants are restricted from altering their capacity holdings change for the first four years of operation post commissioning.

0621A

As 0621 and:

This modification provided additional analysis that a storage discount of greater than 50% should be applied and valued this at 86%. We broadly agree that the benefits to competition and UK security of supply from storage should be appropriately reflected in charging arrangements. We also note that this measure has been adopted by other alternative modifications.

0621B

As 0621 and:

We offer qualified support for some aspects of 0621B noting that it offers some aspects of continuity by keeping some commodity based charging and has a less aggressive impact on competition due to the relative stability between transition and enduring arrangements. This is particularly evident in the derivation of PARCA Security Amounts charged for new transmission capacity. Under 0621B this remains relatively consistent through the transition and enduring period and is in line with historical values.

0621C

As 0621 and:

We offer qualified support for 0621C as it ensures a more measured transition into the enduring arrangements and potentially offers a higher degree of compliance with the EU TAR arrangements. We also agree with the construction of the optional charge which should ensure that imbalances identified with the geographical distribution of charges and potential impacts for new connections to the Transmission System can be in partially mitigated.

0621D

As 0621

We oppose this modification proposal. Though the objective of this 0621D is to mitigate the geographic differentials in charging by applying a square root of distance within the calculation of CWD it leads to an increase in end consumer charges. Using the square root rather than examining the absence of a “*relevant flow scenario*” as required by Article 8.1 (d) provides no greater cost reflectivity. A summary of the analysis completed by National Grid demonstrates that this option also leads to a greater proportion of revenue being collected from Distribution network customers (71.26 % under interim arrangements, 80.94 % under enduring arrangements) then would otherwise be collected under other CWD based proposals. Additional detriment is introduced by the proposal to remove the shorthaul optional charge. This removes any mitigating arrangements for Transmission Connected Customers that are close to entry points, including gas generators. It is noted that the proposal does not remove the existing shorthaul option for gas generators connected to Distribution Networks.

0621E

As 0621 and

We Support the proposer of 0621E that the extended implementation time to transition from interim to enduring arrangements is beneficial to Relevant Objective (C). will enable National Grid to better develop its FCC forecast taking into account alteration of capacity booking behaviour. The extended period of implementation would also enable users to identify any additional consequences that were not previously assessed and introduce appropriate modifications to address any potentially harmful effects.

0621F

As 0621 and

We oppose 0621F as do not believe there is sufficient evidence to support a discount being applied at bi-directional interconnectors. We are also mindful that the cost of any discount applied would be socialised across other users.

0621H

As 0621 and

We feel that introducing an exemption for revenue recovery charges for existing capacity holders would not be an appropriate course of action.

0621J

We oppose the postage stamp reference price methodology as it is not cost reflective and therefore does not reflect underlying marginal investment cost drivers. We accept that the postage stamp method may have a marginal benefit over the 0621 CWD method in that it is highly predictable and reproducible by market participants. This benefit is diluted by the marginally more distortive impact upon competition than other available alternatives that use the CWD model.

In common with proposal 0621 the postage stamp model also has a detrimental impact on new gas generation projects with a higher PARCA security amount of 0.0205 p/kWh/day in the enduring period.

0621K

As 0621 and:

We agree that the proposals generally have not addressed the areas of the value of off peak and interruptible capacity discounts. In the time available there was no consolidated analysis of the use of the various tools available to National Grid or the applicability of the across the board 10%

discount for interruptible products. In light of this we do not support the introduction of 100% interruptible discount for storage sites only.

0621L

As 0621 and:

This proposal could make the charging at Entry more equitable and reduce some of the distortions in 0621. We are not clear that in doing so, if compliance with Art 36 of the Tariff Code would be maintained.

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 would prefer to see an early decision from Ofgem to ensure that participants can prepare for the next capacity market auction in February 2019. We would also propose the adoption of a three-year transition period as proposed by 0621E. This would enable Users to consider the range of impacts and any unintended consequences that could be mitigated by code modifications. This period of transition would also enable National Grid to refine and consult on the methodology for enduring FCC.

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

We would like to refer the panel to the Frontier economics report particularly section 4.6 which highlights the ongoing effect on end consumers and interactions with the electricity markets.

<https://www.energy-uk.org.uk/publication.html?task=file.download&id=6680>

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.*

Insert Text Here

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?*

In addition to the section 10 of the Workgroup report Ofgem should consider

Interaction with the Electricity market

Capacity charge increases are likely to be passed through into the electricity commodity prices and bids into the capacity mechanism. This will not only include the costs for obligated capacity but also the increased charges for interruptible / off-peak capacity. These costs need to be assessed as part of the impact assessment and need to be forecasted forward to assess the impact on current and future gas power stations and gas peaking plant. It is also important for Ofgem to consider what the implications are for the

provision and availability of ancillary services in the future given the changing electricity generation mix.

Given the ongoing TCR for electricity TNUOS residual charges, and Access and forward charging work under the Charging Futures forum we would expect some holistic alignment of charging principals and analysis within the Impact assessment on the potential interactions and costs to customers.

Impact on Gas Generation projects

We have highlighted in our response the potential for distortion between existing and new exit capacity holders. As well as increasing capacity charges once a plant is operational, the charging structure increases the costs to secure a PARCA. This could double in the enduring period. This creates a barrier to entry and puts new and flexible generation plant at a disadvantage relative to incumbents. Incumbents can also alter their capacity holdings to reflect their historical flows, whereas new plants capacity holdings are sized to reflect maximum flows, and are set in the PARCA for the first four years of operation.

As highlighted above interactions with the CM and with system needs should be analysed clearly understood and reflected in the impact assessment.

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)?*

We would add that the introduction of an extended interim period is necessary to understand the full implications and practicalities of producing an appropriate and relevant FCC. We have already identified issues that may impact on future generation projects that would necessitate further code changes to mitigate. Our preference is for an extension of any interim process for a minimum of three years at least whichever modification is chosen. However, this is only proposed in Mod 0621E.

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 recognised that interactions at entry points, timings of auctions and existing capacity holdings need to be fully considered in the impact assessment and in future industry work whichever modification is chosen. There has also been debate in the workgroup over the trading at entry of capacity rights and any implications for compliance with article 35 which requires resolution. We also consider that the PARCA process and arrangements for secondary trading at entry and exit need to be addressed.

- 3. 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 – The proposals are not cost reflective and do not satisfy the requirement to model relevant flow scenarios as envisaged in Article 8.1.(d) and the statement “Where entry

points and exit points cannot be combined in a flow scenario, this combination of entry and exit points shall not be taken into account.

Compliance with Article 5 with respect to cost allocation is also deficient under all but one model. We do recognise that some proposals may be more compliant than the current methodology and we would encourage Ofgem to address any current deficiencies as part of the Impact Assessment.

4. *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?*

The models do give results and it is relatively clear how those results are derived and the assumptions upon which they are based. However, none of the models are cost reflective and we anticipate that dependent on the change implemented there are likely to be negative foreseeable outcomes for the electricity and gas markets that will need addressing through further industry code change.

5. *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 consider that the specific capacity discount for storage sites may be justified. Going forward we see clear benefits for a reassessment of other parameters and operational arrangements including the value of interruptible capacity.

Insert Text Here

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.*

We have noted a number of omissions and areas of concern that have not been addressed fully and should be addressed through the Ofgem Impact Assessment. We draw attention to the response by EUK and report by Frontier Economics which we support.

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

With other members of EUK we agree and support the main arguments of their response to this consultation.

<https://www.gasgovernance.co.uk/sites/default/files/ggf/book/2018-06/Representation%20-%20Energy%20UK%200621.pdf>

We also draw attention to the analysis from Frontier Economics with respect to the charging arrangements which highlights the detrimental impact on customers of the proposed models. Their report is available:

<https://www.energy-uk.org.uk/publication.html?task=file.download&id=6680>