Representation - Modification UNC 0790 (Urgent)

Introduction of a Transmission Services Entry Flow Charge

Responses invited by: 5pm on 06 December 2021

To: enquiries@gasgovernance.co.uk

Please note submission of your representation confirms your consent for publication/circulation.

Representative:	Ricky Hill
Organisation:	British Gas Trading Limited
Date of Representation:	6th December 2021
Support or oppose implementation?	Oppose
Relevant Objective:	**d)** Negative
Relevant Charging Methodology Objective:	**aa)** Negative **c)** Negative

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

British Gas Trading Limited opposes this modification as it is not compliant with UK NC TAR. This has been confirmed by external advice which we will make available to Ofgem on request. The lack of compliance stems from the fact that the exception in Article 4(3)(b) cannot be used in the manner that National Grid proposes. The proposed charge cannot lawfully be used to recover an entirely different 'under-recovery' calculated by reference to the fixed prices applying to Existing Contracts. Furthermore, we do not believe a credible case has been made in favour of National Grid's argument that the current arrangements are detrimental to competition between Shipper Users, and that the proposed commodity charge would better facilitate competition. We elaborate on these points below.

The Article 4(3) of UK TAR NC states that "*the transmission services revenue shall be recovered by capacity-based transmission tariffs*. As an exception, subject to the approval of the national regulatory authority, a part of the transmission services revenue may be recovered only by the following commodity-based transmission tariffs which are set separately from each other:

(a) a flow-based charge, which shall comply with all of the following criteria (i) levied for the purpose of covering the costs mainly driven by the quantity of the gas flow; (ii) calculated on the basis of forecasted or historical flows, or both, and set in such a way that it is the same at all entry points and the same at all exit points; (iii) expressed in monetary terms or in kind.

(b) a complementary revenue recovery charge, which shall comply with all of the following criteria:(i) levied for the purpose of managing revenue under- and over-recovery; (ii)

calculated on the basis of forecasted or historical capacity allocations and flows, or both; (iii) applied at points other than interconnection points; (iv) applied after the national regulatory authority has made an assessment of its cost-reflectivity and its impact on cross-subsidisation between interconnection points and points other than interconnection points."

The additional flow-based entry charge proposed by UNC790 is a charge for transmission services, and so can only be compliant with this Article 4(3) if it falls within the permitted exceptions outline above. In UNC790, National Grid seeks to argue that the proposed flow-based entry charge would be compatible with Article 4(3)(b) because it would be used to manage under-recovery arising from the fixed prices afforded to Existing Contracts. However, this is an incorrect interpretation of under-recovery in Article 4(3). In Article 18, under- or over-recovery is stated to be calculated by subtracting the allowed transmission services revenue from the actual revenue obtained, such that an under-recovery arises where the result is negative. Under UNC790 the reference price is calculated as if existing contracts did not exist, thereby artificially creating an under-recovery.

It is clear that the exception in Article 4(3)(b) can only be used to recover differences between actual and allowed revenue (revenue allowed by National Grid's revenue control licence conditions). Therefore, the exception in Article 4(3)(b) cannot be used in the manner that National Grid proposes. It cannot be used to recover an entirely different 'under-recovery' calculated by reference to the fixed prices paid by Existing Contracts.

For completeness, the exception at Article 4(3)(a) also appears not to apply, as the proposed charge does not reflect costs mainly driven by the quantity of the gas flow.

Notwithstanding that our legal advice shows this modification is unlawful, the entire case of these proposals appears to rest on National Grid's assumption that the arrangements implemented on 1st October 2020 are detrimental to competition between Shipper Users and that the proposed commodity charge would better facilitate competition. British Gas Trading Limited does not believe a credible case has been made with regards to competition and therefore this should not be used as a pretext for implementation. National Grid's own assessment, conducted by Frontier Economics, is also unable to make the case convincingly.[1]

In its assessment of whether UNC790 has a positive impact on competition, Frontier say there are "likely to be *Mixed effects (though unlikely to be material). Could reduce existing distortions to dispatch and barriers to entry (by reducing shipper risks). But exempting interconnection from the flow-based charge could create a new distortion*" (slide 7). On the current arrangements, Frontier goes on to say "*there are economic reasons why the presence of ECs should not result in distortions to competition (between sources at a given Entry Point)*" (slide 10) and the "*use of 'beach swaps' might mean the opportunity cost of EC capacity differs from the Reference Price, but it is unlikely to distort the merit order*" (slide 11).

[1] .https://www.gasgovernance.co.uk/sites/default/files/ggf/book/2021-11/NGG%20Charging%20Reform%20-%20Impact%20Assessment%200790%20%28Urgent%29.pdf

We do not believe there is a credible scenario whereby the current arrangements would negatively impact competition or distort gas flows. Any capacity purchased, whether it is existing or new capacity, is a sunk cost, and shippers may choose to flow against it if the NBP price is above the marginal cost of its source of gas, regardless of what they paid for it. Rather, it is adding a commodity charge, which is not cost-reflective, that would create a distortion and feed through to the NBP price. Furthermore, the regulatory framework allows for gas transportation capacity to be sold on the secondary market, and as in all free markets, the price for that capacity will increase or decrease according to supply and demand.

Implementation: *What lead-time do you wish to see prior to implementation and why?*

We do not believe UNC790 should be implemented for the reasons noted above.

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

We believe we would be negatively impacted from a commercial point of view, but we will not quantify this in a public response.

Legal Text: *Are you satisfied that the legal text will deliver the intent of the Solution?*

Yes.

Are there any errors or omissions in the Modification that you think should be taken into account? *Include details of any impacts/costs to your organisation that are directly related to this.*

As a flow-based charge, the Entry NTS Transmission Services Commodity Charge would feed directly through to the NBP price, increasing it proportionately and negatively impacting consumers and security of supply. We do not believe that sufficient consideration has been given to this area, either in the mod or the assessment by Frontier Economics.

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

More generally, NGG's concern with the current arrangements appears to be the perceived inequity of 'existing' capacity holders benefitting from grandfathered low-cost capacity, whilst other users are 'locked into' buying relatively expensive new capacity. This portrayal of the problem is not correct because of the secondary market. Shippers that do not directly own 'existing' capacity can source it from those that do on the well-operating, liquid, secondary market. Therefore, buying new, relatively high-cost capacity, is not the only option available to Shippers.

Furthermore, the current two-tier system will disappear on its own without intervention, because 'existing' capacity is naturally expiring and will not be replaced[2]. We do not therefore believe it is proportionate, for a perceived issue that will reduce in the coming

[2] We estimate that in 4 years, around 50% of 'existing' capacity will have expired.

years, to introduce an entirely new flow-based charge, which will also impact the NBP price and therefore costs to consumers.