# Potential adjustments to the GB charging regime

NTS CMF

1st June 2021

# Introduction

- The new NTS charging regime from Oct 2020 plus additional revenue recovery charges within year have significantly increased costs to enter/exit the GB network - GB now has the highest entry tariffs among key NW European markets.

- The new charging regime has also created a dual regime between the cost of new bookings & legacy capacity, distorting competition between shippers.

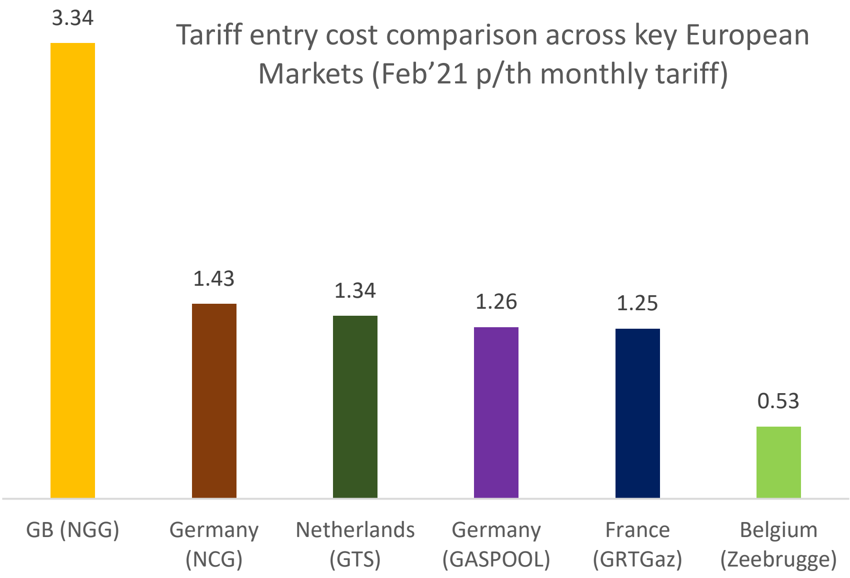
- The high tariffs and dual regime is increasing GB wholesale prices to the detriment of consumers and is a challenge to the competitiveness of cross border trade.

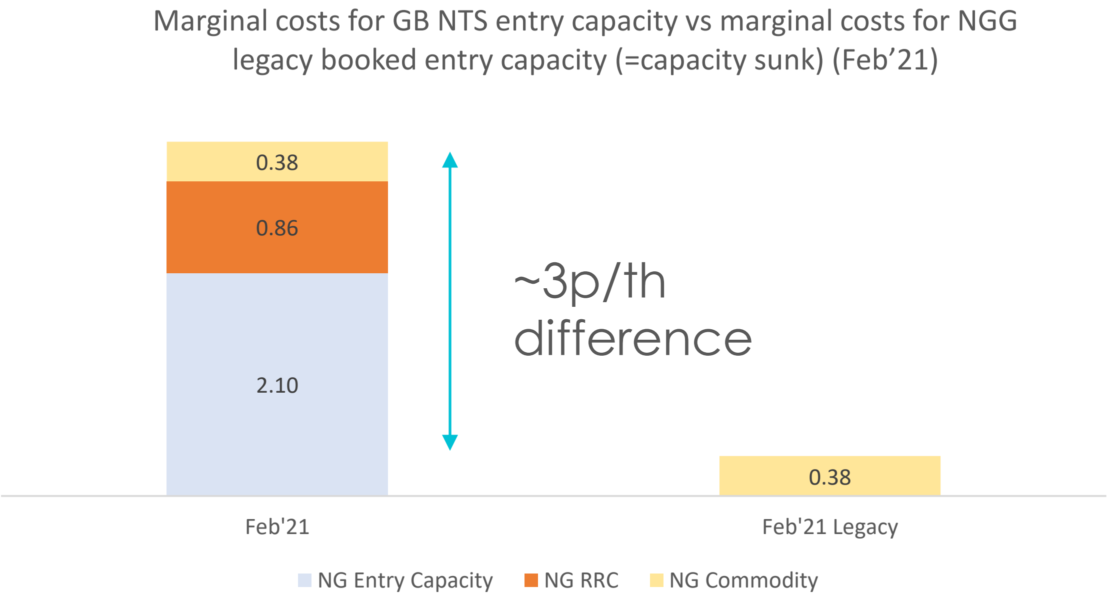
- IUK and BBL commissioned a study from CEPA consultants to analyse the cost and benefits of adjustments to the regime designed to mitigate these challenges. Please see: https://www.cepa.co.uk/news-insights/view/IUK_BBL_Consideration_of_adjustments_to_the_NTS_Charging_Regime

- This presentation outlines the key results from that study. It shows adjustments to the entry/exit split or benchmarking Bacton tariffs, have significant GB consumer welfare benefits whilst being neutral to NG. The increased consumer welfare is driven by resultant lower gas and electricity wholesale prices.

# NTS Tariffs - key issues

1. NTS Entry tariffs are <u>double</u> vs last year and are now the highest in Europe by factor 2.5
2. Part of the NTS's Entry tariffs and the risk of revenue under recovery are not applied equally to all users, creating <u>dual regime and competitive distortion</u>
3. RRC adjustment within year with 1 month notice – <u>creating uncertainty</u> for market participants to book capacity.



# NTS Tariffs affecting cross border trade, GB consumer interest and commercial opportunities

- High entry charges **affects international attractiveness of GB market,** wholesale prices and consumer interest. GB entry prices are the most expensive in key NW Europe markets - over 2.5 times higher than DE (NCG) and ~6 times more expensive than BE (Zee).

- The **dual regime between legacy and new bookings creates a competitive distortion**. This was already flagged by ACER and recognised by Ofgem. LNG and Storage entry points still benefit from large legacy positions on the NTS, whilst this handicap affects imports from Interconnectors (Bacton NTS Entry IP hold less than 1% of existing contracts).

- **Uncertainty about NTS tariffs** lead to shipper's becoming averse to taking positions, **affecting functioning of the markets** (higher price volatility, less hedging etc), affecting consumer interest and security of supply. It also reduces the commercial opportunity and business planning possibilities for infrastructure operators.

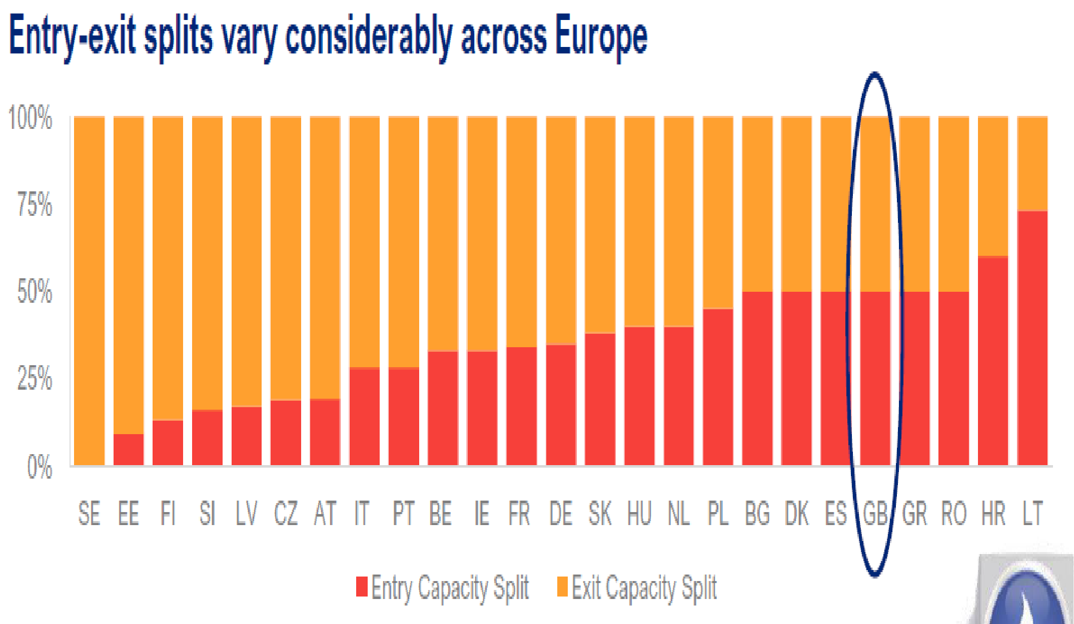
Our view is that the current combination of tariff and market rules works to the detriment of GB shippers and is not in the consumer interest and GB's security of supply

# Study to consider whether adjustments would be in the consumer interest

## IUK, together with BBL, commissioned CEPA to model potential adjustments

- Modelled adjustments in 2022/23 using same methodology developed for the Ofgem UNC678 policy assessment (includes tariff impacts)
- Adjustments modelled:
  - Benchmarking of Bacton tariffs to competitive levels
  - Changing Entry/Exit Split: option 20/80 and option 35/65

| | Status Quo | Option 1.a: 35:65 Entry-Exit split | Option 1.b: 20:80 Entry-Exit split | Option 2a: 69% Benchmark | Option 2b: 50% Benchmark | Option 2c: 36% Benchmark |
|---|---|---|---|---|---|---|
| Storage discount | 80%, as per UNC727 decision | | | | | |
| UNC728 mod | UNC728B, as per minded to decision | | | | | |
| RRCs | None – the model endogenously ensures full revenue recovery | | | | | |
| Existing contracts | Included | Included | Included | Included | Included | Included |
| Bacton IC entry adjustment | None | None | None | 69% – based on average annual entry tariff levels for NWE interconnectors | 50% – based on the next highest annual entry tariff amongst NWE interconnectors | 36% – level that would lead to 10% CAA index incorporating ECs (calculated ex ante) |
| Entry-Exit split | 50:50 | 35:65 | 20:80 | 50:50 | 50:50 | 50:50 |

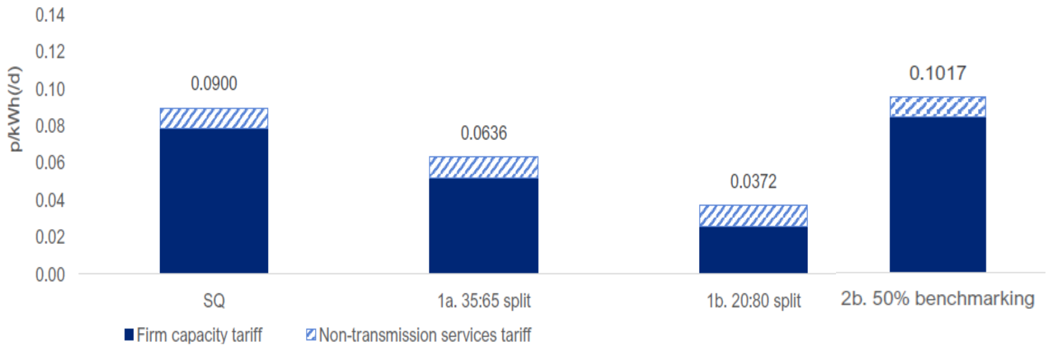


Source: ENTSOG, 2020.

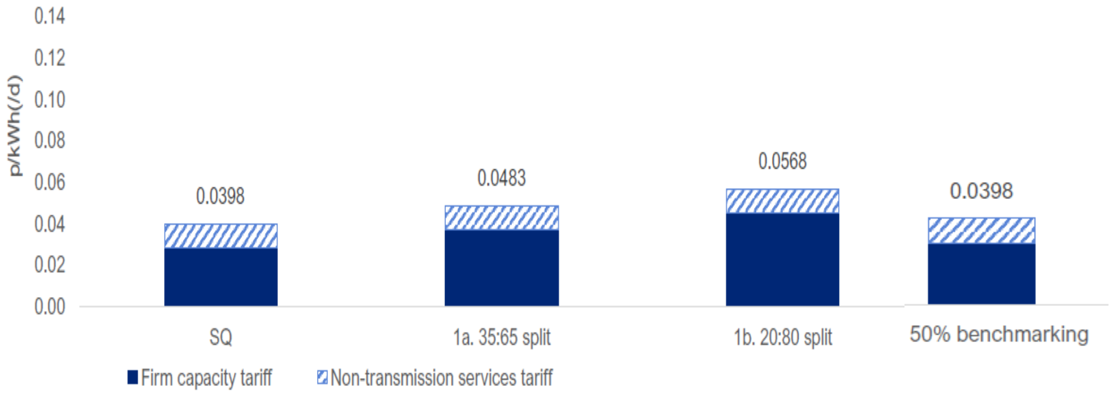
# Sensitivities modelled to consider impact of dual regime and RRC

| | SQ | Sensitivity 1: SQ with RRCs | Sensitivity 2: SQ no ECs |
|---|---|---|---|
| Storage discount | 80%, as per UNC727 decision | | |
| UNC728 mod | UNC728B, as per minded to decision | | |
| RRCs | None – the model endogenously ensures full revenue recovery | Both at Entry and Exit – at 50% of the February 2021 level | None – the model endogenously ensures full revenue recovery |
| Existing contracts | Included | Included | Not included |
| Bacton IC entry adjustment | None | None | None |
| Entry-Exit split | 50:50 | 50:50 | 50:50 |

# GB NTS Tariff impacts when adjusting entry/exit split




**NTS Entry Tariffs**




**NTS Exit Tariffs**

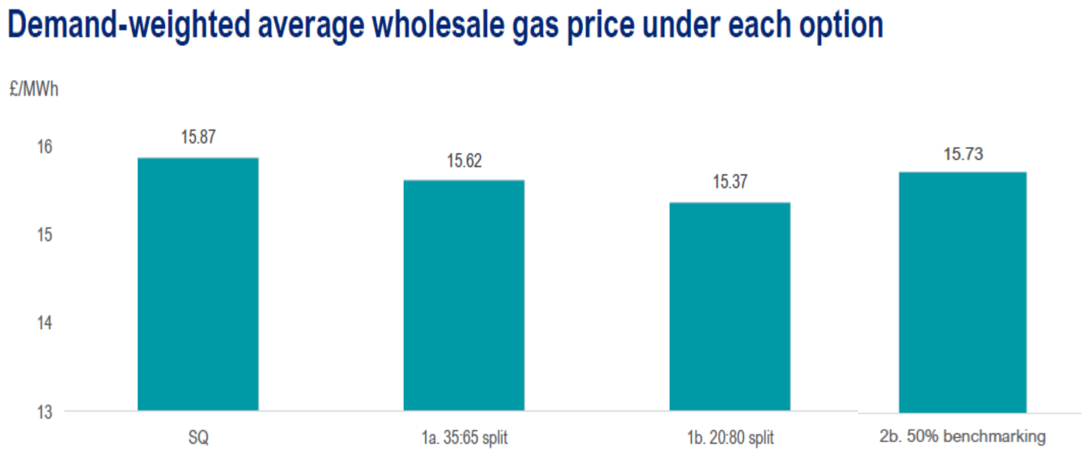
Note: 50% entry benchmarking adjustment - refers to Non Bacton IP entry tariffs

Results from CEPA Study - Tariffs for modelled year 2022/23

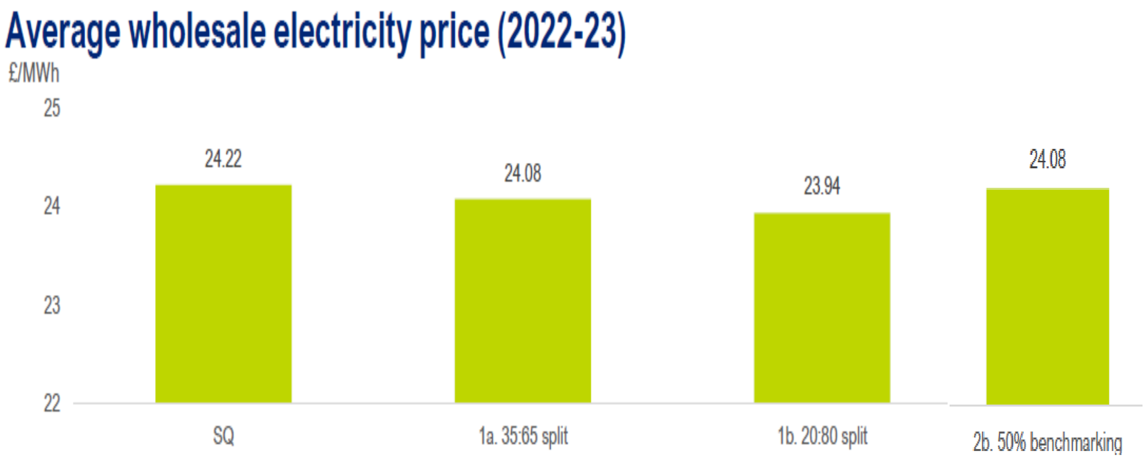
Exit tariff increase significantly smaller than entry tariff decrease as additional revenue is spread across a larger exit booking base.

# Adjustments lower wholesale prices - drive consumer welfare enhancement

- The marginal source of gas determines wholesale price
- Under the entry-exit split options, entry tariffs are lower than under the SQ. As a result, the marginal cost of supply falls for every entry point.
- Under the benchmarking options, a 50% Bacton adjustment lowers the wholesale gas price when Bacton ICs are the marginal source.
- Electricity market results are strongly linked to gas price impacts –with the resulting electricity prices following a similar trajectory as gas prices.




Results from CEPA Study




Results from CEPA Study

# Study indicates adjustments would be in the consumer interest

## Results show adjustments can significantly benefit consumers

| Option | GB gas consumers welfare NPV (Per Annum) | GB electricity consumers welfare NPV (Per Annum) | Total energy consumers welfare NPV (Per Annum) |
|---|---|---|---|
| 20/80 split | £130m | £80m | **£210m** |
| 50% benchmark | £110m | £38m | **£148m** |
| 35/65 split | £65.6m | £40m | **£105.6m** |

- Whilst no change in total costs to consumers (NG allowed revenue the same), consumers benefit from lower wholesale market prices and better wholesale competition (reduced impact of dual regime).

## Modelling of sensitivities highlights elements of current regime harm consumers

- Current ‘dual regime’ (i.e different treatment of existing contracts at Entry) leads to consumer harm, as it distorts the level playing field btwn different supply sources.
- Revenue recovery charge leads to consumer harm in any given year, as it distorts the level playing field & allocates the risk of under recovery to one set of market parties only (new bookings), and hence also the wholesale gas price.

The study has not considered how a sustained distortion might affect the viability of certain supply sources (interconnectors) and their consequences for the GB market security of supply.

# Next steps

- Despite being UK TSOs, we cannot raise a UNC proposal – **requires a Shipper or NG initiative (or Ofgem intervention)**.
- UNC proposal needs to be raised promptly if we wish process to be completed and adjustments to be factored into publication of reserve prices for 2022/23.

## Your feedback

- Initial thoughts on study results and how industry can take adjustments forward?

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