UNC Workgroup 0796 Minutes

Revision to the Determination of National Grid NTS Target Revenue for Transportation Charging

Monday 07 February 2022

via Microsoft Teams

Attendees		
Eric Fowler (Chair)	(EF)	Joint Office
Helen Bennett (Secretary)	(HB)	Joint Office
Alsarif Satti	(ASa)	Ofgem
Anna Shrigley	(ASh)	ENI
Colin Williams	(CWi)	National Grid
Daniel Hisgett	(DHi)	National Grid
Dave A Bayliss	(DAB)	National Grid
Davide Rubini	(DR)	Vitol
Debra Hawkin	(DHa)	TPA Solutions
James Doyle	(JD)	Foxglove Energy Supply Limited
Lauren Jauss	(LJa)	RWE
Nigel Sisman	(NS)	Sisman Energy Consulting
Oliver Weston	(OW)	Ofgem
Richard Pomroy	(RP)	Wales & West Utilities
Tom Stuart	(TS)	Wales & West Utilities

Copies of all papers are available at: http://www.gasgovernance.co.uk/0796/070222

The Workgroup Report is due to be presented at the UNC Modification Panel by 17 February 2022.

1.0 Introduction and Status Review

1.1. Approval of Minutes (01 February 2022)

Eric Fowler (EF) provided a more detailed overview of the minutes from 01 February 2022 noting that participants will not have had a chance to review them prior to this meeting. Nigel Sisman (NS) advised he will submit some wording to be included regarding the inconsistency of the Legal drafting. The minutes were conditionally approved pending NS comments.

1.2. Approval of Late Papers

EF advised Workgroup is has been hard over the last couple of days to keep up with the flow of papers for participants to read ahead of the meeting, this is mostly a symptom of such short timescales in between meetings.

1.3. Review of Outstanding Actions

No outstanding actions

2.0 Review of Amended Modification

Colin Williams (CWi) was asked to provide an overview of the amendments made to the Modification (v3.0 04 February 2022).

Solution:

The Diagram shown on page 11 has now been updated to illustrate the determination of the Allowed Revenue for the Gas Year for Transmission Services (same approach for Transmission Services Entry and Exit). The diagram shows the determination using Transmission Services Entry as the example and the same approach is applied for Transmission Services Exit.

- The text box at the top of the diagram has been added for clarity.
- All algebra has been updated to align to the solution text
- Further clarification has been added to show how the fraction is determined that apportions a fraction of the revenue for FY + 1.
- The diagram is based on Entry and can easily be replaced with Exit algebra and would work in exactly the same way.

Referring to changes made to the Solution 1.6.2 d), CWi advised he has added the inclusion of K for Entry and K for Exit. This was in the previous solution as part of the total revenues, however splitting out the detail to make easier to follow felt appropriate.

CWi clarified that this method in the solution is focusing on the stability of revenues over time and is a method that will improve the stability of revenues over time.

By going into a Year applying this method, where it is knowingly going to under or over-recover in the Formula Year. Accommodating the anticipated under or over recovery into the Formula Year FY + 1 this means part of it goes will still not be accommodated within the Gas Year being priced. Therefore, if you are going to under-recover, you will still under-recover. The approach that this proposal makes will help to manage the step change in revenue and avoiding putting all the under or over recovery into the next Year, in which case it is helping to manage that revenue volatility over time.

RP asked, in a previous arrangement, did National Grid take K into account in terms of the second Formula Year? CWi advised the Regulatory Year and Gas Year has the misalignment. Recovery is currently only focused on recovery during the Regulatory Year. This approach causes some revenue volatility (that by default drives price volatility). What the proposed methodology does is mitigates this some of that for the purposes of managing the revenue volatility.

RP asked if this is a Licence compliance issue? CWi advised he does not think there is an issue with TAR Code. In terms of the Licence, there is potentially an issue if there needs to be an over recovery which would not currently be permitted by the Licence. Under-recovery versus the target is technically permitted within the Licence.

RP asked if the Modification is contingent on the Licence change being granted? CWi advised the Modification is not contingent, but it is a change that would be helpful.

Referring to changes made to the Solution 1.6.2 e), CWi advised reference to the Gas Year had been added and as this referred to Entry twice, it now refers to both Entry and Exit. The text also reflects the solution outlined at NTSCMF on 1st February and in the diagram to show that it is a proportion for Gas Year y.

CWi confirmed, this methodology will look to improve revenue volatility. It focuses on revenue inputs and the stability of them. On their own this can help price stability as there is a direct link. It does not try to address other sources of potential volatility in prices. He added there are a number of other factors that would cause price volatility, which is one of the reasons behind *Modification 0790 - Introduction of a Transmission Services Entry Flow Charge*.

When asked if all of the revenue deferral is picked up by the K value, CWi clarified the projection going forward, is that it will be partly in the current Gas Year and the remainder will go into the following Gas Year.

NS sought clarification of his understanding of the Modification commenting that it is geared up to try to address the pricing volatility, with a further revenue smoothing being applied suggesting they may not make further adjustments which could re-introduce an element of price volatility.

NS indicated National Grid will be projecting, whenever they are doing the price setting process, revenue under or over-recovery, this will then be feeding back into later allowed revenues and consequently the Target Revenue, however, National Grid will still end up with an under or over-recovery. NS wanted to confirm that this will not be a recursive process whereby National Grid continually update to address that the revenue shortfall, or over-recovery, which would take us back to the original problem. It does seem like that there is a new idea that is being introduced in which it is dealing with a trade-off between reducing price volatility and addressing National Grids revenue uncertainty.

CWi clarified that the Modification will be looking at addressing revenue volatility across years and this proposal does this. Pricing is linked to revenues, all else being equal, if revenues are more stable, prices will be too.

Anna Shrigley (ASh) confirmed that ENI welcomes National Grid initiative to raise Modification 0796 and suggested that it is delivered and implemented and then the feedback is analysed before Modification 0790 can be assessed. ASh asked for a comment to be included in the Workgroup Report that ENI do not believe Modification 0796 is complimentary to Modification 0790 and that Modification 0796 should be implemented before Modification 0790 is considered.

Davide Rubini (DR) asked if this Modification trades off having a smaller change at the end of each Gas Year with some tariff changes throughout the Gas Year, he said if implementation of the changes of the tariff are at the end of each Gas Year, will the change be smaller, would achieving this outcome entail changes at the tariff level throughout the Gas Year. CWi clarified that once the tariff is set it remains as set. For any of the anticipated under or over recovery driven by the 0796 change it would not be sought by other charges within year. Capacity reserve prices, once set, are fixed for the tariff period (Gas Year).

Debra Hawkin (DHa) asked how National Grid will work out which part of K will be changed. CWi clarified that when National Grid are setting this charge, only the K for the current Formula Year is affected. The best estimate of K will be applied to the end of the current Formula Year only driven by the 0796 methodology.

CWi advised, without the K value, the estimation would be further out than having it in.

DHa sought confirmation of the understanding of the approach for this Modification in that it involves a two-stage process that first of all carries out the calculation to derive a Gas Year price and then look at the amount of revenue that National Grid are going to recover for the end of the Formula Year that ends within the Gas Year, then there is the projection of the K value which is then added and effectively repeated in the tariff calculation.

David A Bayliss (DAB) confirmed the approach. He explained the price is initially set which is driven on a pricing consideration and then an adjustment is applied to get the initial set price closer to the revenue requirement associated with the Formula Year.

DHa suggested this solution seems as though National Grid are mitigating some of the same benefits of price smoothing that there is within the calculation of the first Gas Year price.

DAB further added National Grid are looking at setting the price for the Gas Year but are also setting indicative prices for a further four years out, these are used by the Industry as part of setting the auction prices for the Monthly System Entry and Quarterly System Entry (MSEC and QSEC) Capacity Auctions which are based on indicative prices.

For example in year 1 the revenue might be 40 million under recovery, if you do not account for that in the K value, the allowed revenues that are being used for Formula Year are going to be 40 million less than they will be when it comes to price setting, the indicative prices are going to be wrong and the prices that are used to set the auctions will be incorrect, this process is building in the known transfer of allowed revenues across the years to try to accurately portray, not only this Gas Year price, but also the indicative prices to be as accurate as they can be, the K value cannot be ignored when it comes to that process otherwise indicative prices will be deliberately set that are not going to be reflective of the actual charges when they are published.

NS noted that the prices set will be based upon an unknown incorrect value and will be therefore incorrect, and he does not think that is in accordance with the intent of what National Grid are trying to do with this Modification. He suggested that the "K" value should be feeding through into the allowed revenues in later Year to replace those numbers coming out of the Price Control Financial Model (PCFM) which NS feared might have been based on an inappropriate methodology.

DAB clarified that this methodology will build the known over and under-recoveries into the allowed revenues for the future years based on the 0796 approach which can be reasonably foreseen, all else being equal as there will be an under or over recovery as a result of its application.

NS noted that the UNC Charging Methodology interactions with the Licence are quite tricky to understand. He noted others in the meeting had differing interpretations of the interactions compared to his understanding.

When DAB suggested the solution to this Modification is the most logical approach, some Workgroup participants agreed that the solution within this Modification is better than the current situation. Some participants felt there may be other options to deal with this.

3.0 Review of Legal Text

The Legal Text was reviewed as part of the Amended Modification discussion.

4.0 Completion of Workgroup Report

In undertaking a detailed onscreen review of the draft Workgroup Report (v0.4 , dated 07 February 2022), EF completed amendments and updates in-line with the feedback provided by Workgroup participants.

Workgroup had no further comments to add to the Consumer Impacts and Consumer Benefit areas of the Workgroup Report.

Workgroup Impact Assessment

A further point was added from NS which noted the approach to the adjustment for K ending in the Formula Year within the Gas Year is likely to mitigate the price smoothing that is the objective of the Modification by placing an undue weight on Formula Year revenue recovery.

The comments made by ASh that the Modification should be implemented, and that ENI does not agree that it is a complimentary Modification to Modification 0790 were added to this section.

A further point was made with regards to the rebate where Workgroup asked CWi for an example. CWi referred Workgroup to the relevant section in the Modification:

It is worthy of note that the purpose of this charge it somewhat less relevant under the current commercial landscape as in recent years competitive auctions are not driving up the Entry Capacity payable price materially above the Reserve Price which has limited the effect of driving an over-recovery against Allowed Revenue. The rebate was primarily introduced as a mechanism to return excess revenue driven by pure market activity in auctions increasing the payable price. However, the current 'top down' approach where capacity reference prices are derived by dividing capacity into a target revenue thereby leaving less likelihood of significant driving up of prices from the Reserve Price to the payable via the auctions (as was assumed under the LRMC regime) makes it less relevant and applicable. Hence National Grid is of the view it is appropriate to remove this charge.

Relevant Objectives:

The Relevant Objectives were reviewed, Workgroup had no further comment.

At this point in the meeting it was identified that the meeting was inquorate, EF took an action to clarify what happens if Workgroup starts quorate and during the completion of the Workgroup Report the meeting becomes inquorate.

It was noted that the Legal drafting appears to deliver on National Grid's intent.

James Doyle (JD) agreed this is not the best solution, however, in the interest of progress, supports the Modification going through and that a better representation from other Shipper entities would be preferable.

Recommendations

Workgroup participants agreed to proceed to submit the Report to UNC Modification Panel for consideration on 17 February 2022.

CWi requested the following counter argument to a better solution to be added to the Workgroup Impact Assessment, and added that anybody can consider raising an alternative Modification:

Counter argument:

The proposer countered the approach mentioned as the inherent approach to pricing is centred on a Gas Year and this has been maintained. By linking strictly to a Formula Year as was mentioned, it would mean calculating pricing for a FY to achieve the result, and FY prices do not exist in the tariff methodology and goes against the requirement to price for a Gas Year and also presents issues in replicability and transparency.

Workgroup concluded.

5.0 Any Other Business

None.

6.0 Diary Planning

Further details of planned meetings are available at: www.gasgovernance.co.uk/events-calendar/month

Workgroup meetings will take place as follows:

Time / Date	Paper Publication Deadline	Venue	Workgroup Programme
No further meetings			

Action Table (as at 07 February 2022)

Action Ref	Meeting Date	Minute Ref	Action	Owner	Status Update
No outstanding actions					