Gas Transmission

NTSCMF

National Grid Charging Open letter

06 July 2021

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National Grid’s open letter and further charging reforms

- With a new regime implemented from 01 October 2020 a number of issues have taken place resulting in quick remedial action to address such as the use of Revenue Recovery charges and implementing UNC0748.
- National Grid has also taken the decision to defer £45m from Formula Year 2021/22 to Formula Year 2022/23 as a means to help reduce the volatility in target revenues based on the values known in setting October 2021/22 charges.
- Open letter: https://www.nationalgrid.com/uk/gas-transmission/charging/gas-charging-discussion-gcd-papers (under “May 2021 - Open Letter on the Future Of Gas Transmission Charging”
- Whilst early into the new regime, the events above in addition to Stakeholder feedback and further thinking, have highlighted the need for some further changes to the charging framework.
- Structural aspects of the methodology (such as how target revenues are determined and the specifics of the tariff calculations) will need to be reviewed
- Reviewing how volatility manifests via the methodology is important to understand and why the sensitivities on prices can occur, especially on Entry Capacity Reserve Prices

National Grid's open letter and further charging reforms

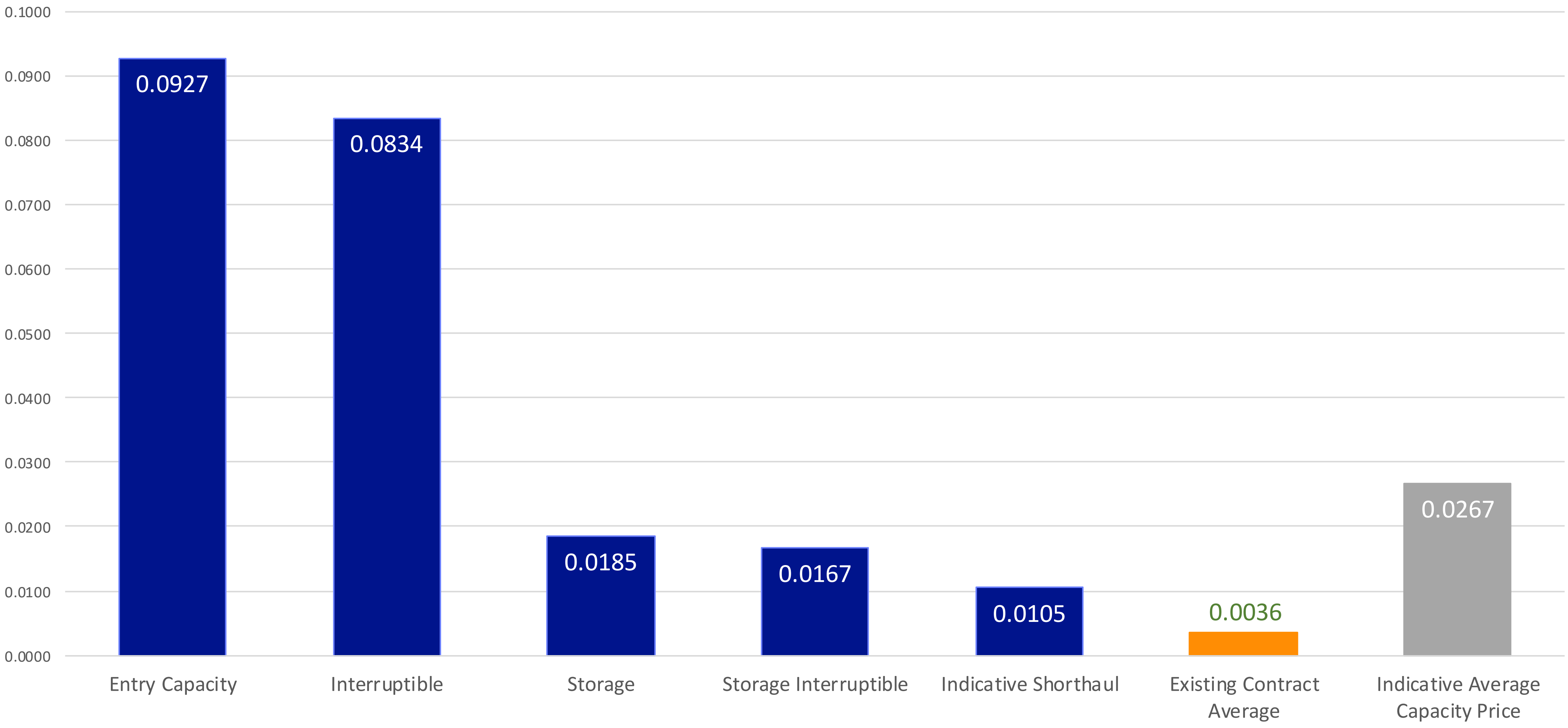
- Unless addressed risks remain of:
  - Potential sizeable revenue swings tariff year to tariff year leaving volatility of prices an ever present and likely risk;
  - Consistently high Entry Reserve prices relative to the average overall and to the average Existing Contract price impacting the fairness of the regime especially for those small volumes (as a total of Entry bookings) paying the prevailing rates.
- To address this we believe changes are necessary and, to improve these areas, it should be our collective focus to address the causes and drivers of revenue/tariff volatility as a matter of priority

Tariffs example as per Open Letter (May 2021)

Reflecting on the published tariffs for October 2021, the following prices were given in the National Grid Open Letter, this shows the range of prices which could be applicable at different Points and across different Users.

p/kWh/d	Oct 21 Entry Capacity Reserve Prices	Oct 21 Exit Capacity Reserve Prices
Capacity Reserve Price	0.0927	0.0211
Interruptible Capacity Reserve Price	0.0834	0.0190
Storage Capacity Reserve Price	0.0185	0.0042
Storage Interruptible Capacity Reserve Price	0.0167	0.0038
Indicative Shorthaul Average Price	0.0105	0.0050
Existing Contract Average Price	0.0036	n/a
Indicative Average Capacity Price	0.0267	0.0195

Entry Capacity GY Oct 21 – Sep 22: Average Capacity Prices (p/kWh/d)



Why is change needed – Tariffs example

- On the Entry Tariffs specifically there is a substantial difference between the Firm Entry Capacity Price and the average Existing Contract (EC) Price
- The differential is largely driven by the low denominator that attracts the published Entry Capacity Reserve Prices
  - This low denominator increases sensitivity to changes such as revenues and the impacts on tariffs and is likely to be an issue that will remain for some time if left unchanged

p/kWh/d	GY Oct 21 – Sep 22 Entry Capacity Reserve Price	Price Difference (EC compared to Oct 21 Entry Capacity Reserve Price)
Entry Capacity Reserve Price	0.0927	96%
Existing Contract (EC) Average Price	0.0036	

Existing Contract (EC) and their 'influence' on reserve prices

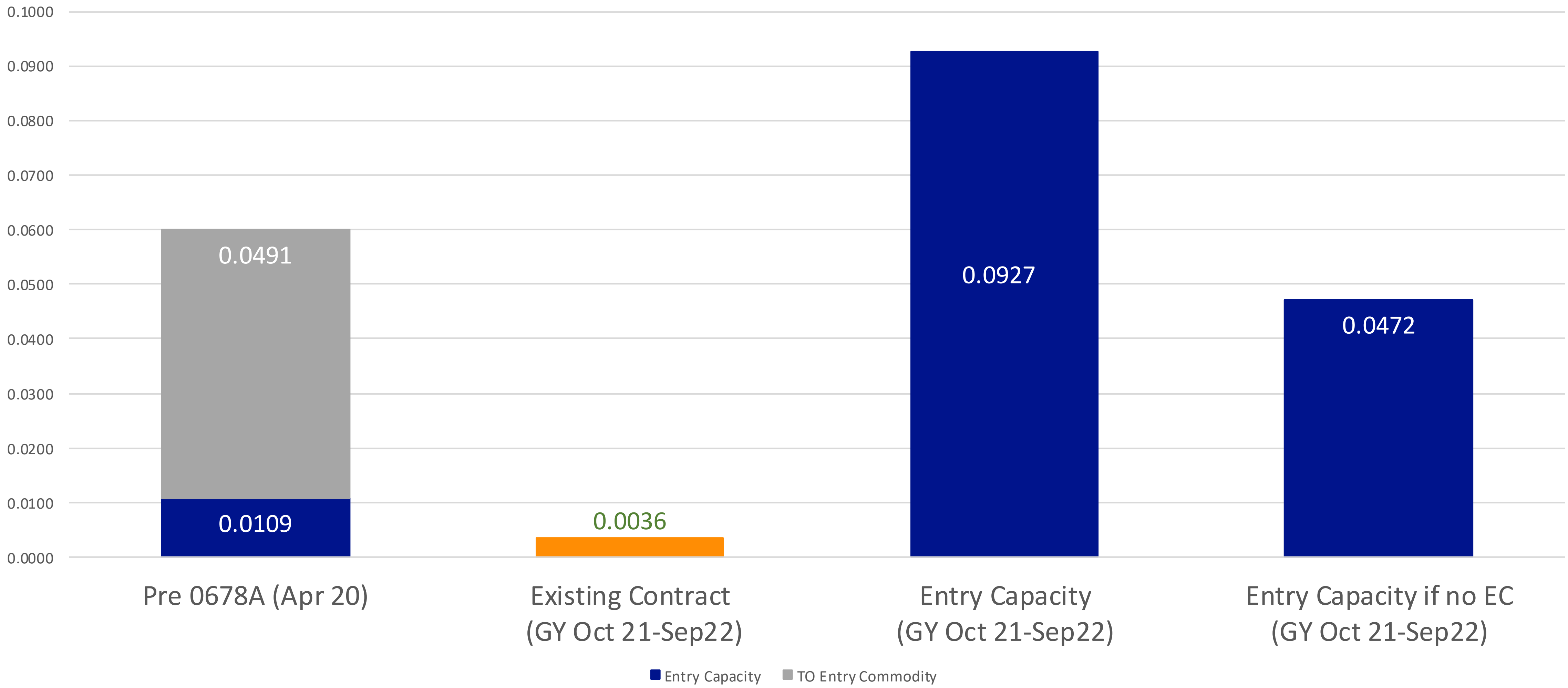
The following steps used to calculate a Capacity Reserve Price with EC's removed (for illustration only):

- Removal of Existing Contracts (EC) from the FCC calculation means most Point values would be more closely representative of Expected Flow rather than Existing Contract Bookings as current
- NTS Optional Charge (Shorthaul) Revenues are adjusted to account for an expected increase in Eligible Quantities when Existing Contracts are removed.
- Revised FRY and Allowed revenue calculations taking into account changes above
- Illustrative Reserve Prices (with EC removed) were recalculated without adjusting any other existing parameters

p/kWh/d	GY Oct 21 – Sep 22 Entry Capacity Reserve Price	Price Difference
Capacity Reserve Price	**0.0927**	**51%**
Capacity Reserve Price (with EC removed) – for illustration only	**0.0472**	

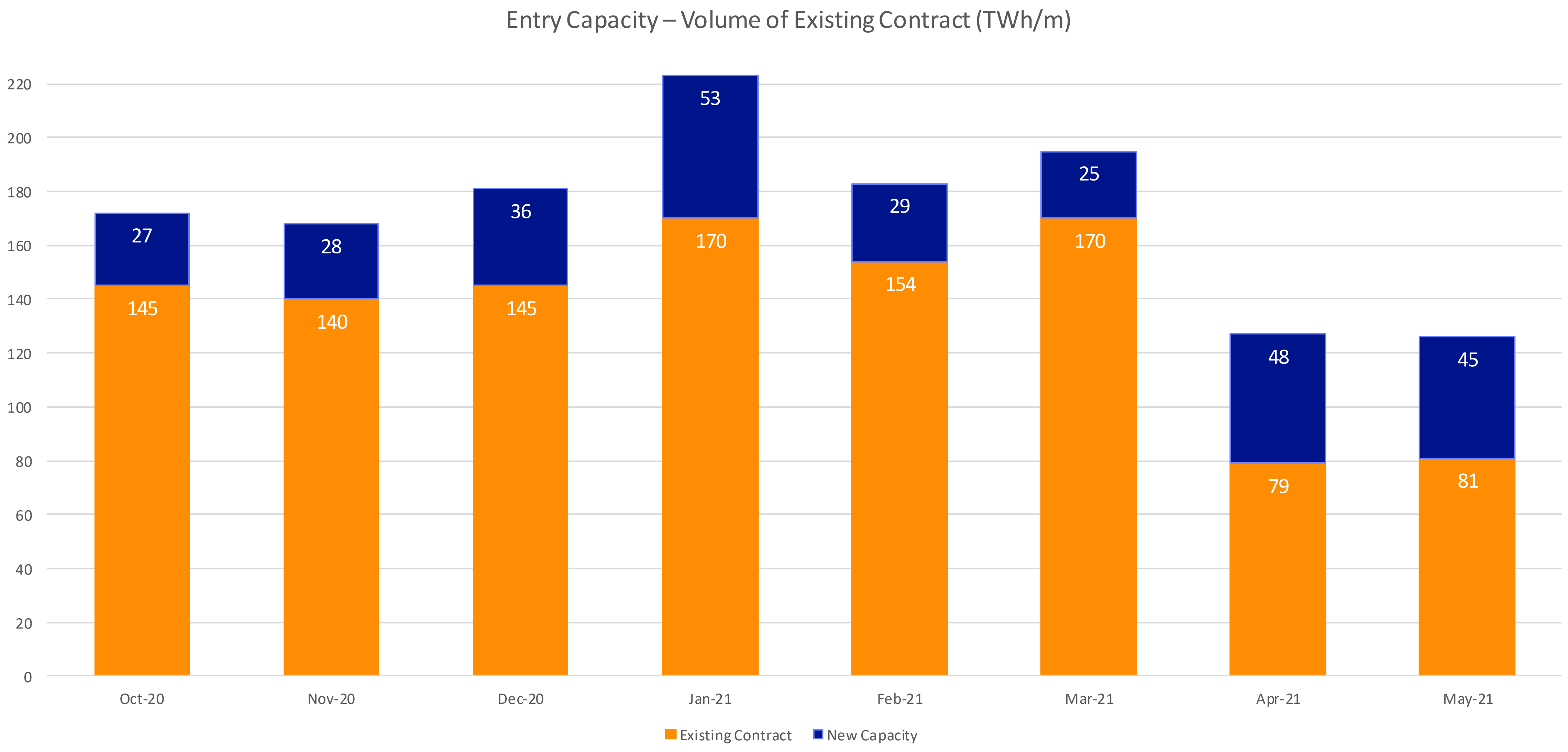
- Entry Rates are significantly lower than current due to the increase in the denominator following removal of Existing Contract fixed prices, bringing them more closely in line with historic Capacity & Commodity combined rates.
- Lower Rates are still seen at Exit compared with adjusted Entry Rate, primarily due to the level of GDN bookings

Entry Capacity Prices – current regime compared to previous regime

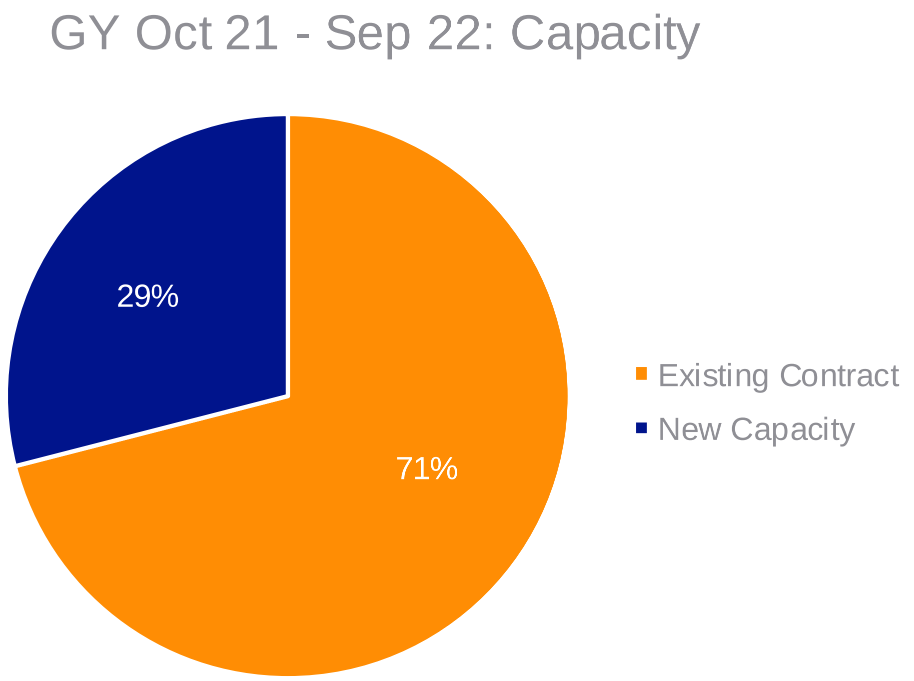


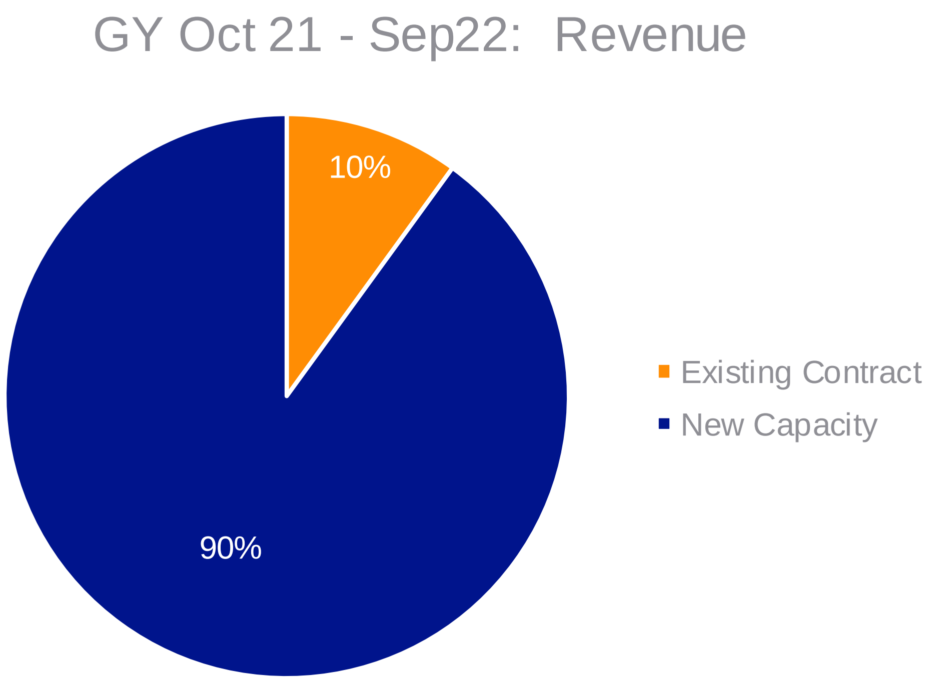
Note: Entry Capacity Price used for Apr 20 of 0.0109 p/Kwh/d is weighted average price

Entry Capacity – Volume of EC vs new capacity booked



EC’s and their ‘Influence’ on Reserve Prices





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Sensitivities to revenue collection and timescales of ECs

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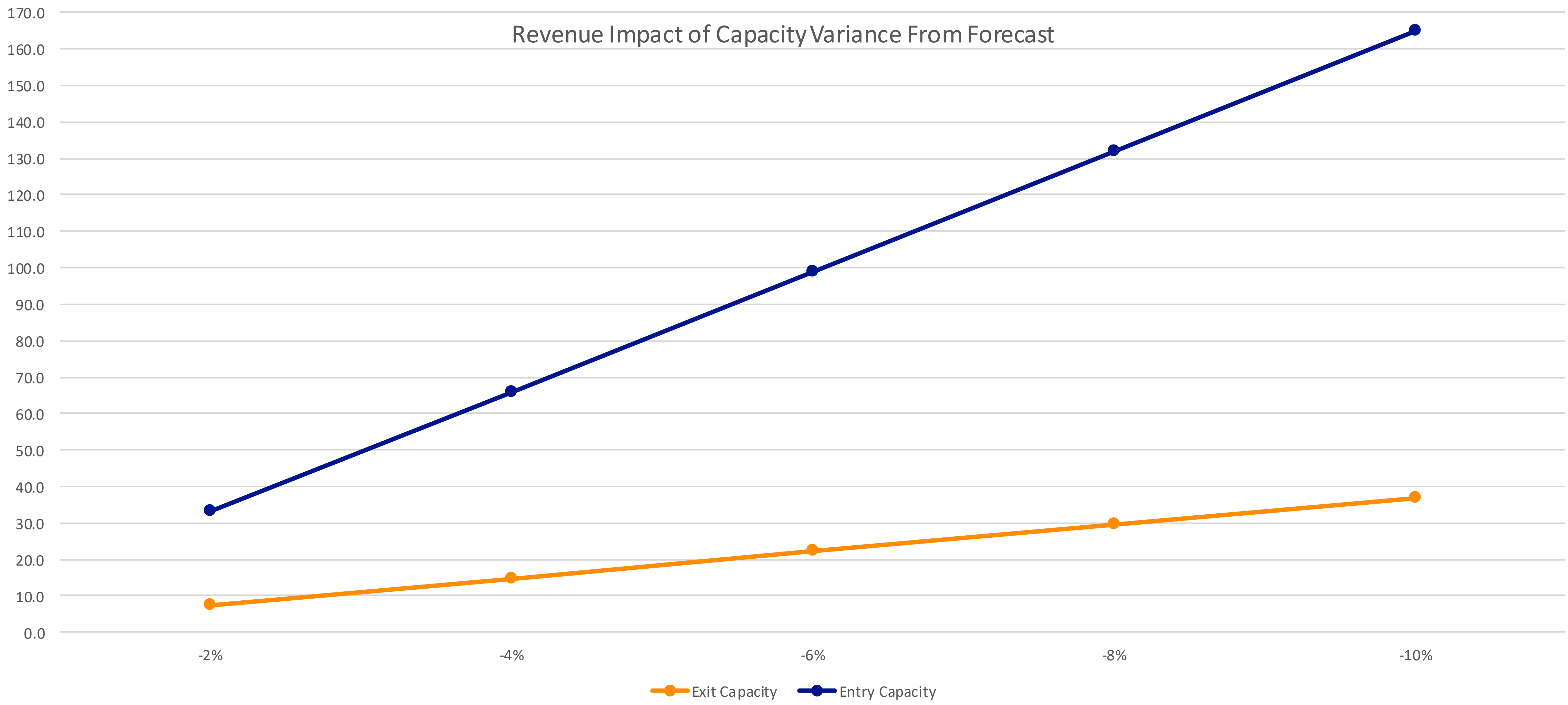
Sensitivities to revenue collection and not going away

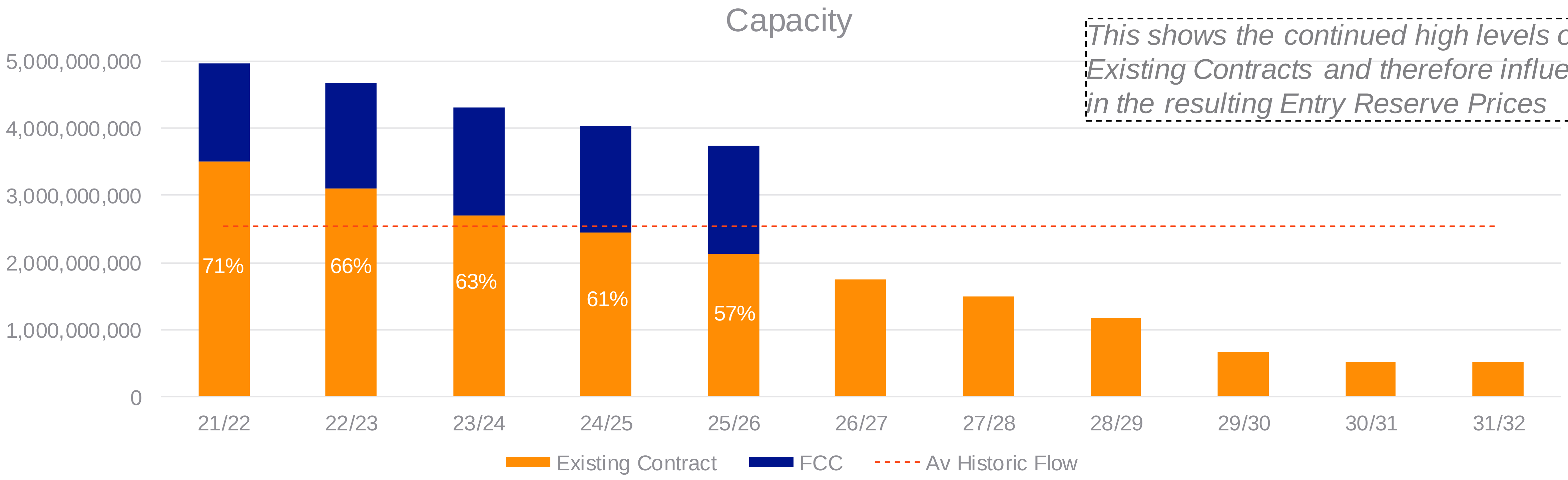
- To show the revenue sensitivity on Entry and Exit we can consider a % shortfall in capacity bookings versus forecast. This shows that Entry has a greater impact than Exit for any % shortfall.
- To do this we have assumed a series of % reductions from the relevant FCCs
  - For Entry, the reduction is against the overall FCC and ECs (unchanged) are then netted off. This then reduces the capacity bookings that would be subjected to the reserve price. This then produces an assumed under collection compared to target.
  - For Exit, the reduction is against the overall FCC. This then reduces the capacity bookings that would be subjected to the reserve price. This then produces an assumed under collection compared to target.
- This shows that, for example, a 6% reduction to both Entry and Exit would result in:
  - £22m under collection on Exit
  - £99m under collection on Entry
- Any such values would then impact either the risk of needing Revenue Recovery charges and / or the carry over into subsequent years charges, driving further volatility more so on Entry. This level of sensitivity, with Entry being more susceptible to larger changes, will continue as the EC influence remains substantial.

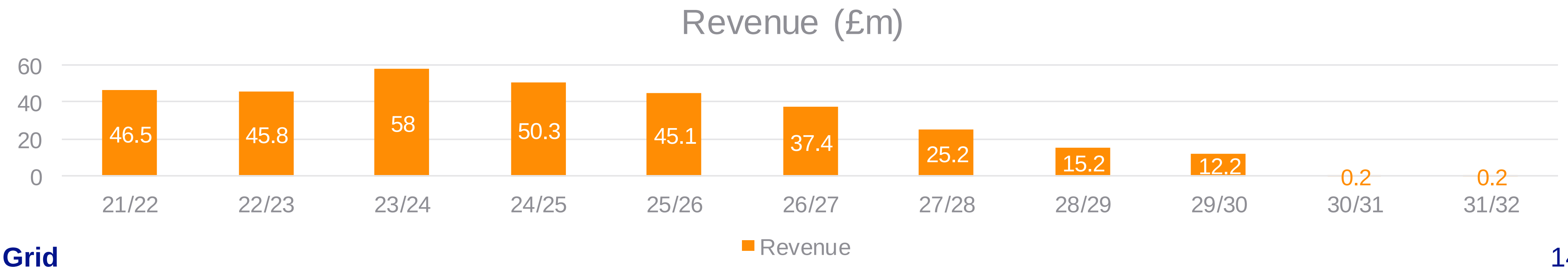
Entry & Exit Capacity Indicative Sensitivities (£m)



EC Capacity and Revenues (Entry) 2021/22 – 2031/32

This shows the continued high levels of Existing Contracts and therefore influence in the resulting Entry Reserve Prices





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Transportation Charges:

Likely change areas and timings

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Charging Changes: Likely Change Areas

Themes for change

Area of focus	Considerations
Tariffs	How to update the tariff calculations to reduce likelihood of unsustainable high prices and the differential paid across all Users. Reduced sensitivity in the price calculations where small changes to inputs can result in significant changes to the charges. This should improve sensitivity of tariffs to change such as where small input changes to revenues can drive large swings in tariffs
Revenues	How the determination of the target revenues for the Tariff Year could be improved to better manage sensitivity to change, improve predictability and reduce the resulting revenue volatility. This would impact revenues and would unlikely, by itself remove the differential in reserve prices over the future years

- It is, in our view, necessary for changes to make charges more equitable. It is likely that a combination of changes in both categories will deliver the optimal to the framework. It is essential that the ‘problem statement’ is clear in terms of what any change proposals are looking to address as the options are considered.

- Changes to these topics, notably the tariffs category can cover many aspects and for these it will be necessary to put these on two likely timelines (with shorter term changes for GY Oct 22 to Sept 23 and beyond this from GY Oct 23 to Sept 24 onwards)

Charging Changes: Timings

Timescales

Within the area of charging changes there could be multiple pieces of work running in parallel with different timescales.

Timing	Considerations
Short Term	Changes aiming to be implemented in time to set Transmission Services Charges applicable from 01 October 2022. This would mean the UNC changes would need to be in place by May 2022.
Medium Term	Working in parallel with the Short term to consider changes together to benefit from the ongoing discussions. Changes would be aiming for a likely 01 October 2023 implementation, or earlier if possible. Likely to be some topics that will take longer due to complexity.

The length of time it takes to develop the Modification(s) and for the Modification(s) to be considered, including potential impact assessments or consultations to be completed, this all needs to be taken into account within any development timelines.

As an example UNC0728/A/B/C/D, took 10 months from urgency being granted in June 2020 to a final decision being made in April 2021 on UNC0728B.

Next Steps

- National Grid welcomes all views on the open letter and on areas that could be aspects for change
- We plan to develop options and present our views back to Stakeholders for their views and with likely UNC changes to follow shortly.
- In order to work with the UNC change process proposals will need to be discussed and raised soon, in the coming months to give best possible chance of successfully implementing for 01 October 2022 and into further years as appropriate
- National Grid will use NTSCMF as it provides a constructive home for discussing these topics.
- We also plan to host a focused webinar on this on **21 July 2021** where we plan to share some more details on our thoughts on the likely options to take forward including UNC change timelines. Given the recent publications we also plan to use this Webinar to cover details on the prices set from 01 October 2021.
- Feedback is welcome through NTSCMF and through National Grid's webinar and direct to National Grid using the details at the end of this pack
- From August 2021 focused change discussions can take place

Contact

General Questions

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