

Modification proposal:	Uniform Network Code (UNC) 419: Redefining the capacity of the Specified Exit Point used in the calculation of the NTS Optional Commodity tariff (UNC419)		
Decision:	The Authority ¹ directs that this proposal be made ²		
Target audience:	The Joint Office, Parties to the UNC and other interested parties		
Date of publication:	20 July 2012	Implementation Date:	To be confirmed by the Joint Office

Background to the modification proposal

National Grid Gas plc (NGG) is the System Operator (SO) and the Transmission Owner (TO) of the GB National Transmission System (NTS) for gas transportation. To recover its regulated allowed revenue in respect of its gas transportation activities, it levies use of system charges on NTS users. SO allowed revenues are recovered through application of an SO commodity charge to entry and exit gas flows³. TO allowed revenues are principally recovered through entry and exit TO capacity charges, but where revenues from these charges do not fully recover NGG's TO allowed revenue, a TO commodity charge is levied to make up the shortfall⁴.

The NTS Optional Commodity charge (also known as the "short haul charge") is available to all NTS users and can be paid as an alternative to standard TO and SO commodity charges. If NTS users flowing gas over relatively short distances - for example, a power station close to an NTS entry point, had to pay standard commodity charges, this could create an incentive for them to build a dedicated pipeline to by-pass the NTS. This would not be efficient as by-passing the NTS would lead to duplication of the pipeline system and higher overall charges for other NTS users and for GB gas consumers. The short haul charge was introduced to reflect the costs of transporting gas over relatively short distances and to ensure that connecting to the NTS would be economic relative to other options.

The short haul charge is based on the gas flow rate and distance of a notional NTS pipeline. In order for NGG to calculate the charge, a user must specify a non storage site⁵ entry point and an exit point (or multiple exit points)⁶ for the gas flow. The charge in p/kWh is calculated based on the flow rate and distance between the specified entry and exit points using the following function derived by NGG:

$$1203 * [(SOQ)^{-0.834}] * D + 363 * (SOQ)^{-0.654}$$

¹ The terms 'the Authority', 'Ofgem' and 'we' are used interchangeably in this document. Ofgem is the Office of the Gas and Electricity Markets Authority.

² This document is notice of the reasons for this decision as required by section 38A of the Gas Act 1986.

³ Neither of these commodity charges applies to gas entering or exiting storage sites except for gas which is offtaken at storage sites as 'own use' gas.

⁴ NGG recovers half of its TO allowed revenue from entry charges and half from exit charges. In recent years, revenues from TO entry capacity charges have been lower than expected. Consequently, the TO commodity charge has recovered a higher proportion of NGG's TO allowed revenue.

⁵ Storage sites cannot be nominated as entry or exit points in calculating the charge because NGG considers that including them would undermine the principle that standard commodity charges are paid in respect of stored gas pays when the gas enters and exits the NTS.

⁶ Shippers can nominate multiple exit points and a single entry point. The optional commodity charge is levied on the smaller of the two daily shipper allocations at the exit points, with the assumption that any 'extra' gas must have come from another entry point or alternatively flowed to another exit point.

Where:

- $1203 * [(SOQ)^{-0.834}]$ are the distance related costs;
- $363 * (SOQ)^{-0.654}$ are non distance related costs;
- D is the distance of the specified exit point from the specified entry point; and
- SOQ is the Standard Offtake Quantity.

The SOQ term currently takes the value of capacity at the specified exit point as defined in the UNC. The UNC currently defines capacity at the specified exit point as being the NTS user's nomination or booking amount as provided in the Supply Point Administration process for Supply Meter and Shared Meter Points⁷, and, at Connected System Exit Points (CSEPs)⁸, the maximum amount of gas NGG can make available for offtake in a 24-hour period.

However, from 1 October 2012⁹ the UNC definition of capacity at the specified exit point will change to the sum of Baseline NTS Exit (Flat) Capacity and Baseline NTS Exit (Flexibility) Capacity¹⁰. Baseline NTS Exit Capacity equates to the level of capacity NGG is obliged to provide as set out in its gas transporter licence.¹¹ Because a number of NTS exit points have an "obligated capacity" level of zero, this will create a problem for the calculation of the short haul charge: inputting a zero SOQ value into the formula creates a charge rate equal to infinity. Consequently, from 1 October 2012, a short haul charge cannot be defined for exit points with an obligated capacity level of zero.

The modification proposal

UNC 419 proposes to redefine the capacity at the specified exit point within the UNC. For NTS exit points, except interconnectors with no physical offtake capability¹², the capacity at the specified exit point will be the Maximum NTS Exit Point Offtake Rate (MNEPOR)¹³ converted into kWh/day¹⁴. The MNEPOR is a measure of the maximum instantaneous rate at which NGG determines gas can be offtaken at an exit point before a physical constraint is reached. The determination of the maximum rate is based on a number of factors including meter readings taken at the exit point and the diameter of the gas pipeline. NGG considered that the option of reverting to NTS users' capacity bookings would be unworkable from 1 October 2012 because there are NTS exit points with a booked capacity level of zero from that date.

UNC Panel¹⁵ recommendation

The UNC Panel met on 20 June 2012 to vote on whether or not to recommend the implementation of UNC 419. The Panel voted unanimously in favour of recommending implementation of the proposal.

⁷ UNC TPD G5.4.1 and G5.4.4

⁸ UNC TDIIC 9.5.5(c)(iv)

⁹ This is a consequential change associated with the implementation of reformed exit arrangements as provided for by UNC 195AV.

¹⁰ UNC TPD B3.12.10(b)

¹¹ "Obligated levels of capacity" are the baseline levels of capacity NGG is funded to provide through its price control. These capacity values are set out in Special Condition C8E of NGG's gas transporter licence.

¹² For interconnector exit points without physical capability the instantaneous rate at which it is feasible to input gas into the NTS at the relevant system entry point (expressed in kWh/day) is proposed as a proxy for offtake capability.

¹³ The MNEPOR is defined in UNC TPD B3.6.6.

¹⁴ Because the MNEPOR is a measure of instantaneous offtake it is usually expressed in kWh/hour. This will be converted to kWh/day for use in the short haul charge.

¹⁵ The UNC Panel is established and constituted from time to time pursuant to and in accordance with the UNC Modification Rules.

The Authority's decision

We have considered the issues raised by the modification proposal and the Final Modification Report (FMR) dated 21 June 2012. We have considered and taken into account the responses to the Joint Office's consultation on the modification proposal which are attached to the FMR¹⁶. We have concluded that:

- 1. implementation of the modification proposal will better facilitate the achievement of the relevant objectives of the UNC¹⁷; and**
- 2. directing that the modification be made is consistent with the Authority's principal objective and statutory duties¹⁸.**

Reasons for the Authority's decision

In reaching our decision, we have considered the modification proposal against the relevant UNC objectives under Standard Special Condition (SSC) A11(1) of the Gas Transporter Licence. We have set out our views in relation to objectives SSC A11(1)(c) and (d) below. We consider that the proposal is neutral when assessed against the remaining UNC objectives and we have therefore not considered these UNC objectives further. In reaching our decision we have also considered the responses to the consultation on the proposal. Five consultation responses were received, each in support of implementation, and no substantive issues were raised against implementation.

SSC A11(1)(c) so far as is consistent with sub-paragraphs (a) and (b), the efficient discharge of the licensee's obligations under this licence

Under its licence¹⁹, NGG must maintain a charging methodology which reflects the costs incurred in its transportation business. The short haul charge reflects the costs of laying and operating a dedicated NTS pipeline, and for NTS users flowing gas over short distances, can be an economic option relative to paying standard commodity charges. In our view, UNC 419 will meet relevant objective (c) by ensuring that the short haul charge remains accessible to all NTS users, and remains a charge which reflects the costs of laying and operating a dedicated NTS pipeline.

Because a number of NTS exit points have an obligated capacity level of zero, we accept that the definition of exit point capacity within the UNC from 1 October 2012 means that the short haul charge will be unworkable for some NTS users unless it is redefined. We also accept that reverting to booked capacity levels as per the current UNC definition would be problematic as some NTS exit points have a booked capacity level of zero from 1 October 2012 as well. In our view, using the MNEPOR is an appropriate and cost reflective substitute for obligated capacity levels for the purpose of calculating the short haul charge from 1 October 2012. We note that our views on this matter apply only to the use of the MNEPOR for the purpose of calculating the short haul charge and should not be interpreted as applicable to any other use of system charging product.

¹⁶ UNC modification proposals, modification reports and representations can be viewed on the Joint Office of Gas Transporters' website at www.gasgovernance.com

¹⁷ As set out in Standard Special Condition A11(1) of the Gas Transporters Licence, see: <http://epr.ofgem.gov.uk/Pages/EPRInformation.aspx?doc=http%3a%2f%2fepr.ofgem.gov.uk%2fEPRFiles%2fStandard+Special+Condition+PART+A+-+Consolidated+-+Current+Version.pdf>

¹⁸ The Authority's statutory duties are wider than matters which the Panel must take into consideration and are detailed mainly in the Gas Act 1986.

¹⁹ Standard Special Condition A5: Obligations as Regard Charging Methodology

SSC A11(1)(d) so far as is consistent with sub-paragraphs (a) to (c) the securing of effective competition: (i) between relevant shippers; (ii) between relevant suppliers; and/or (iii) between DN operators

In our view, not implementing the proposal would lead to discrimination between NTS users and would be detrimental to competition. Unless the proposal is implemented, from 1 October 2012, NGG will be unable to determine a short haul charge for NTS users who specify an exit point with an obligated capacity level of zero. This will mean that some NTS users will be able to access the short haul charge while others will be required to pay standard commodity charges, whether it is economic for them to do so or not. This could expose some NTS users to a level of cost not faced by other NTS users. This could put upward pressure on prices, or, in marginal cases, could deter market entry, both of which would be detrimental to competition and against the interests of GB gas consumers.

In assessing the proposal, we have also considered the impact the proposal could have on the level of short haul charges faced by NTS users from 1 October 2012 compared to the prevailing level of short haul charges for the current gas year. As part of this assessment, we asked NGG to provide us with the short haul charges currently paid by NTS users, and forecasts of the short haul charges that NTS users would pay from 1 October 2012, both by using the prevailing methodology, and by assuming the proposal is implemented.

The data provided by NGG confirm that, for some NTS users, using the prevailing methodology would prevent the short haul charge being calculated from 1 October 2012; those users would be required to pay the standard commodity charge, which would see their charges increase very significantly. Comparing short haul charges for the current gas year with the level of charges forecast if the proposal is implemented reveals that of the 22 NTS users who currently access the short haul charge, 17 would see their charges change by 0.0005 p/kWh or less, with seven of these seeing no change at all. NGG forecasts that five NTS users who currently pay the short haul charge would face higher charges under the proposal. For most, the extent of the forecast increase is small, and although an increase in the region of 10% is forecast for two users, the forecast charge in both cases remains approximately 90% less than the standard commodity rate.

On the basis of the data provided to us by NGG, we are content that defining exit point capacity within the UNC using the converted MNEPOR value as proposed would be an appropriate substitute to using obligated capacity levels and, compared to the prevailing level of short haul charges, would have a relatively small impact on the level of charges faced by NTS users. We are also content that not implementing the proposal would be inappropriate as it would result in a very significant increase in charges for those NTS users no longer able to access the short haul charge.

Decision notice

In accordance with Standard Special Condition A11 of the Gas Transporters Licence, the Authority hereby directs that modification proposal UNC 419 be made.

**Andy Burgess, Associate Partner, Transmission and Distribution Policy
Signed on behalf of the Authority and authorised for that purpose.**