

## Stage 01: Modification

At what stage is this document in the process?

# 0517A:

## Review of the Supply Matching Merit Order in Setting Capacity Charges and Timing of Resultant Price Changes



The Merit Order within the Transportation Model used in calculating capacity charges was implemented as part of GCM16 in 2009. At the time the Merit Order reflected the utilisation of supply. The Merit Order should be kept under review and updated if required.

In recent years there has been a change in the utilisation of supply around the Liquefied Natural Gas (LNG) and Mid Range Storage (MRS). There has been an increase in the amount of MRS utilised in recent years and a decrease in the amount of LNG that is being utilised. Though both these sources have been utilised on any cold day in the past 4 years, the change in utilisation should be reflected in the Merit Order in TPD UNC Section Y.

Unfortunately the size of the change in NTS exit capacity charges resulting from this change is material in some LDZs. Therefore it warrants a delay in implementation to avoid adverse unintended consequences on NTS directly connected sites and Gas Distribution Networks.



The Proposer recommends that this modification should be:

- assessed by a Workgroup



High Impact:

Gas Distribution Network Operators in WS, SW and SE LDZs, Shippers and Suppliers to NTS directly connected sites in WS, SW and SE LDZs



Medium Impact:  
None



Low Impact:

National Grid Transmission, Gas Distribution Network Operators Shippers and Suppliers in LDZs not listed above

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## About this document:

This Modification Proposal will be presented by the proposer to the panel on 18 Dec 2014.

The panel will consider the proposer's recommendation and agree whether this Modification Proposal should be:

- referred to a workgroup for assessment.


<b>Any questions?</b>
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# 1 Summary

## Is this a Self-Governance Modification?

Self-Governance does not apply as this Modification Proposal is likely to impact commercial activities connected with the shipping, transportation or supply of gas conveyed through pipes.

## Is this a Fast Track Self-Governance Modification?

Fast Track Self-Governance does not apply as it is not properly a house keeping Modification Proposal.

## Why Change?

The Merit Order within the Transportation Model was implemented as part of GCM16 in 2009. At the time the Merit Order reflected the utilisation of supply. National Grid must keep the charging methodology under review as part of its Licence conditions. Therefore the ordering of the supply source groups should be kept under review to reflect further developments in supplies and be consistent with what happens on the network.

In recent years there has been a change in selective utilisation of Liquefied Natural Gas (LNG) and Mid Range Storage (MRS). There has been an increase in the use of MRS and a decrease in the amount of LNG that is being utilised. Both these sources have been utilised on any cold day in recent years.

Unfortunately the size of the change in NTS exit capacity charges resulting from this change is material in some LDZs. Therefore it warrants a delay in implementation to avoid adverse unintended consequences on NTS directly connected sites and Gas Distribution Networks.

The consequences of not approving this variation to Mod 517 would be increased charging volatility and the creation of possible competition distortion between sites connect to LDZs and those directly connected to the NTS.

Sites connected directly to the NTS should not be adversely impacted compared to those sites connected to the GDNs. Furthermore, without visibility, current NTS changes have a material effect on cash flows for some Gas Distribution Networks.

The new charging arrangements and principles contained within RIIO GD1 promote transparency and visibility of future charges to shippers and end users. The outcome of Ofgem's consultation on predictability and stability of charges ensures that Gas Distribution Networks cannot pass on changes to NTS exit capacity charges until two years after they come into effect. Therefore sites connected to the Gas Distribution network are currently protected. Delaying NTS price changes until Gas Distribution Network allowances are changed will provide the same protection for NTS directly connected sites and avoid charging volatility. A more detailed explanation is provided in the Section 2 "Why Change".

## Solution

It is proposed to amend the current Merit Order which is specified in UNC TPD Section Y so that it aligns to the current utilisation of the supplies in the current years.

This Modification Proposes proposes to amend the Merit Order to combine the supply which is against MRS and LNG into one group within the Merit Order and prorate as currently specified in the methodology.

In order to implement for both NTS Entry Capacity charges and NTS Exit Capacity charges in a reasonable timeframe, the implementation of the change to the Merit Order for use in calculating NTS Entry Capacity Reserve Prices and NTS Exit Capacity charges should subject a notice period.

## Relevant Objectives

Implementation of this Modification Proposal would facilitate the following Relevant Objectives:

- a) Save in so far as paragraphs (aa) or (d) apply, that compliance with the charging methodology results in charges which reflect the costs incurred by the licensee in its transportation business;
- aa) That, in so far as prices in respect of transportation arrangements are established by auction, either:
  - (i) no reserve price is applied, or
  - (ii) that reserve price is set at a level -
    - (I) best calculated to promote efficiency and avoid undue preference in the supply of transportation services; and
    - (II) best calculated to promote competition between gas suppliers and between gas shippers;
- b) That, so far as is consistent with sub-paragraph (a), the charging methodology properly takes account of developments in the transportation business;
- c) that, so far as is consistent with sub-paragraphs (a) and (b), compliance with the charging methodology facilitates effective competition between gas shippers and between gas suppliers;

We believe that the obligation in section 9 of the Gas Act obligation to develop an economic and efficient system is also relevant and that this alternate better facilitates delivers this obligation.

## Implementation

No implementation timescales are suggested at this time. Wales & West Utilities will discuss this through the workgroups.

## Does this modification affect the Nexus delivery, if so, how?

This does not affect the Nexus delivery.

## 2 Why Change?

The Transportation Model calculates the Entry and Exit Capacity reserve prices. Within the Transportation Model there is a specific Merit Order to scale the supplies to meet demand. For the Transportation Model to run the supplies must equal the demand. This Merit Order should reflect supply utilisation and the merit order to use supply types is specified within TPD UNC Section Y – Section 2.5.1(c).

The Merit Order used within the Transportation Model was implemented as part of GCM16 which was implemented in 2009. At the time the Merit Order, which is currently specified within Section Y and the Transportation Model reflected the supply utilisation.

The current Merit Order within the UNC and Transportation Model is specified as below and the adjustment shall be carried out by reducing supplies in the following order to the point at which supplies equal the forecast demand:

- (i) short range Storage Facilities;
- (ii) mid range Storage Facilities;
- (iii) LNG Importation Facilities;
- (iv) long range Storage Facilities;
- (v) pipeline interconnectors; and
- (vi) beach terminals.

In recent years the utilisation of supply on a highest demand day data based on the percentage of supplies has changed. There has been an increase in MRS and a decrease in LNG utilised over recent years.

Financial Year	LNG	MRS
2010/2011	17.36%	3.77%
2011/2012	18.70%	12.12%
2012/2013	7.70%	16.79%
2013/2014	2.47%	13.24%

The data above shows a change in the amount of LNG and MRS supply used on the cold day in the applicable year. With the reductions in LNG over these years being representative of the general trend in use of LNG as a supply source, the value for 2013/14 may be lower than it would otherwise have been due to additional global factors at the time such as the use of LNG in Japan.

LNG and MRS have both been used during cold days over the past 4 years therefore we are proposing an amendment to the Merit Order within the Transportation Model.

The utilisation at entry points has changed since GCM16 was implemented in 2009 and we recognise that this could change in the future and therefore the merit order will need to continue to be reviewed as and when it may be required to be consistent with what happens on the network.

The proposed change will have a material effect on NTS exit capacity charges in some LDZs including Wales South, South West and South East and may have a material effect on the viability of NTS directly connected sites as well as on the cash flows of Gas Distribution Networks. For this reason the implications of the implementation of this Modification Proposal need to be well understood before they are made.

### **Transparency**

In 2007/8 Gas Distribution Networks (GDNs) introduced the Mod 186 report which is presented to members of the Distribution Charging Methodology Forum (DCMF) on a quarterly basis: Jan/Apr/July/Oct. The report provides Shippers, principally, with a detailed analysis of the Allowed Revenues and potential changes to transportation prices for the current year and the next four years, separately identifying Distribution Exit Capacity and Non-Exit Capacity revenues. The report is designed to give Shippers an indication of how transportation prices may move during the four years following the current year.

This does not exist for NTS, although we recognise that NTS are considering introducing something similar. The material impact of the proposed changes in this Modification Proposal highlights the need for a similar process for NTS pricing.

### **NTS Exit Charging Regime & RIIO**

From October 2012, as a result of exit reform, Gas Distribution Networks are now charged by NTS for NTS exit capacity. Previously this charge was paid by Shippers directly. Gas Distribution Networks are now exposed to changes in NTS charges.

The new RIIO GD1 Special Condition 1D of the Gas Distribution Licence states

“The difference between exit capacity charges from NTS and the exit capacity allowance (‘true up’) is adjusted in formula year T+2”

This means that if charges from NTS exceeded the Exit Capacity allowance for 2015/16 the difference cannot be recovered from Shippers connected to the Gas Distribution Network until 2017/18. Sites directly connected to the NTS would incur the revised NTS exit capacity charges immediately.

### **Charging Impact of Modification 517**

For WWU the increase in costs resulting from Modification Proposal 0517, compared to the latest indicative Exit Capacity prices from October 2015, would be approximately £1.0m each month from October 2015.

In the formula year 2015/16 this would amount to an increase in charges over a 6 month period from the NTS of £6m. (£23m to £30m).

Comparing the latest indicative Exit Capacity prices from October 2016 to similar Exit Capacity prices under Modification Proposal 0517, the costs for the formula year 2016/17 would increase by £12m (from £23m to £35m).

In terms of charges to Shippers, if we assume similar Exit Capacity prices were used from October 2016 the price adjustment to WWU Exit Capacity Charges in 2017/18 and 2018/19, following the two year lag, would be +41% and +17% respectively. This compares to price adjustments in 2017/18 and 2018/19 of 4% and 11% using the latest indicative Exit Capacity prices from NTS which reflect the current Merit Order.

If Exit Capacity allowances were adjusted to match the increased costs from 2017/18 then the corresponding price adjustments to WWU Exit Capacity Charges would be 15% in 2017/18; and 16% in 2018/19.

The much larger increase in 2017/18 for 0517 compared to 0517A is due to the effect of the 'true up' arising from the difference between the Exit Capacity allowances and costs in 2015/16 feeding through.

## **RIIO GD1 requirements & Principles**

Ofgem's "Decision in relation to measures to mitigate network charging volatility arising from the price control settlement" included the following statements:

*"We also noted in our consultation that stability of charges would also help improve the efficiency of energy markets by reducing administration costs, eg the costs of suppliers notifying customers of changes in charges."*  
(Paragraph 1.11)

"The majority of respondents agreed that improving the predictability of charges should be the primary objective, however some also noted the importance of stable charges particularly for those consumers on non fixed price contracts, where any change in network charges may be passed on to them by their supplier."  
(Paragraph 1.12)

<https://www.ofgem.gov.uk/publications-and-updates/decision-measures-mitigate-network-charging-volatility-arising-price-control-settlement>

Gas Distribution Networks and NTS both operate under the same Gas Act obligation to develop "an economic and efficient network". Therefore the conclusion that stability of charges would help improve the efficiency of energy markets also applies to the NTS and the conclusions of Ofgem's decision document should also apply to NTS charges

We believe that as Modification Proposal 0517 would result in material rebalancing of NTS charges (but not to the total NTS revenue) it should follow a similar time frame to that which applies to changes to Gas Distribution Networks Exit Capacity allowances. This will facilitate relevant objective (b) "reflecting changes in the transportation business" to a greater extent than Modification Proposal 0517 as it also reflects changes in approaches to charging in transportation businesses.

We accept that the NTS charges need to be cost reflective but this change has material impacts on both Shippers and Gas Distribution Networks, therefore the impact of this proposed change needs to be understood and delaying the implementation date and the introduction of a NTS "Mod 186" process will enable these steps to be undertaken. Although this means that NTS charges will be less cost reflective in the period up to October 2017 we believe that this consideration is outweighed by the effects on competition and on the stability of Gas Distribution Network charges in the affected LDZs. This competition issue has arisen owing to a combination of Exit Reform and the changes to Gas Distribution Network charging described above.

If Gas Distribution Networks wish to apply to Ofgem for an increase in their NTS Exit Capacity allowances they have to apply by 31<sup>st</sup> July 2015 in order to be able collect the additional revenue during the 2017/18 formula year onwards. This means that the information that they require to support the application needs to be available in advance of 31<sup>st</sup> July 2015 to allow sufficient time to prepare the application. This in turn means that forward looking NTS prices need to be provided and the implementation of the change to the Transportation Model needs to be delayed so that prices do not change until 1st October 2017. We believe that this will both avoid adverse impact on Gas Distribution Networks and ensure that there is no adverse effect on competition between sites that are directly connected to the NTS and those that are connected to Gas Distribution Networks.

### 3 Solution

It is proposed to amend UNC TPD Section Y – Section 2.5.1 (c) to ensure that the Merit Order specified in the UNC is reflective of how supplies are currently utilised.

This proposal seeks to amend the Merit Order to combine MRS and LNG into one group within the Merit Order and prorate the supplies (i.e. use an equal % of each group to achieve the supply and demand match required) when matching demand in accordance with the process specified in the methodology.

It is proposed that the NTS pricing methodology in Section Y regarding the merit order is effective from a future date to allow the GDN Exit Cost Allowances to be amended. Given the process for Gas Distribution Networks to apply for a change to NTS Exit Capacity allowances, the resulting changes to the model and resultant indicative charges need to be published by NTS by 30th June in any given year.

The NTS Exit Capacity charges would become effective 27 months after the relevant 30<sup>th</sup> June and the NTS Entry Capacity charges would become effective 20 months after the relevant 30<sup>th</sup> June. This would not change the timescales for setting the final NTS Entry Capacity reserve prices nor final NTS Exit Capacity charges and only informs the merit order to be used.

The published indicative prices would use the current model up to the end of the notice period and then the changed model would be used. The NTS Exit Capacity charges would be implemented on 1<sup>st</sup> October 27 months after the relevant 30<sup>th</sup> June. To be consistent between Exit and Entry the corresponding Entry Capacity charges would be implemented on 1<sup>st</sup> April 21 months after the relevant 30<sup>th</sup> June. This would mean that both the Entry and Exit Capacity charges resulting from a change in the Transportation Model were implement in the same Formula year (April to March).

The table below gives an example for a model changed and indicative charges published by 30<sup>th</sup> June 2015

<b>Prices published</b>	<b>Model used</b>
NTS exit capacity charges for 1 <sup>st</sup> Oct 2015	Current model
NTS entry capacity charges for 1 <sup>st</sup> Apr 2016	Current model
NTS exit capacity charges for 1 <sup>st</sup> Oct 2016	Current model
NTS entry capacity charges for 1 <sup>st</sup> Apr 2017 and thereafter	Changed model
NTS exit capacity charges for 1 <sup>st</sup> Apr 2017 and thereafter	Changed model



User Pays

Classification of the modification as User Pays, or not, and the justification for such classification.

No User Pays service would be created or amended by implementation of this modification and it is not, therefore, classified as a User Pays Modification.

Identification of Users of the service, the proposed split of the recovery between Gas Transporters and Users for User Pays costs and the justification for such view.

Not applicable

Proposed charge(s) for application of User Pays charges to Shippers.

Not applicable

Proposed charge for inclusion in the Agency Charging Statement (ACS) – to be completed upon receipt of a cost estimate from Xoserve.

Not applicable

## 4 Relevant Objectives

Impact of the modification on the Relevant Charging Methodology Objectives:	
Relevant Objective	Identified impact
a) Save in so far as paragraphs (aa) or (d) apply, that compliance with the charging methodology results in charges which reflect the costs incurred by the licensee in its transportation business;	Positive
aa) That, in so far as prices in respect of transportation arrangements are established by auction, either: (i) no reserve price is applied, or (ii) that reserve price is set at a level - (I) best calculated to promote efficiency and avoid undue preference in the supply of transportation services; and (II) best calculated to promote competition between gas suppliers and between gas shippers;	Positive
b) That, so far as is consistent with sub-paragraph (a), the charging methodology properly takes account of developments in the transportation business;	Positive
c) That, so far as is consistent with sub-paragraphs (a) and (b), compliance with the charging methodology facilitates effective competition between gas shippers and between gas suppliers; and	Positive
d) That the charging methodology reflects any alternative arrangements put in place in accordance with a determination made by the Secretary of State under paragraph 2A(a) of Standard Special Condition A27 (Disposal of Assets).	None
e) Compliance with the Regulation and any relevant legally binding decisions of the European Commission and/or the Agency for the Co-operation of Energy Regulators.	None

- a) Save in so far as paragraphs (aa) or (d) apply, that compliance with the charging methodology results in charges which reflect the costs incurred by the licensee in its transportation business;

The implementation of this modification would align to the current supply source utilisation and ensure that the Entry and Exit reserve prices are reflective and consistent with what happens on the network.

- aa) That, in so far as prices in respect of transportation arrangements are established by auction, either:
- (iii) no reserve price is applied, or
  - (iv) that reserve price is set at a level -
  - (I) best calculated to promote efficiency and avoid undue preference in the supply of transportation services; and
  - (II) best calculated to promote competition between gas suppliers and between gas shippers;

The implementation of this modification would align to the current supply source utilisation and ensure that the Entry and Exit reserve prices are reflective and consistent with what happens on the network.

- b) That, so far as is consistent with sub-paragraph (a), the charging methodology properly takes account of developments in the transportation business;

This modification will take into account developments that have taken place since the current Merit Order was introduced as part of GCM16 in 2009. This modification seeks to update UNC TPD Section Y to amend the Merit Order to reflect the current supply utilisation. This modification will also reflect developments in thinking about charging predictability and volatility. Not implementing any changes in charges resulting from the change to the Transportation Model until after the notice period reflects Ofgem's decisions on the volatility and predictability of network charges.

- c) That, so far as is consistent with sub-paragraphs (a) and (b), compliance with the charging methodology facilitates effective competition between gas shippers and between gas suppliers;

This Modification Proposal will result in changes to NTS exit capacity charges being reflected in prices charged to sites directly connected to the NTS at the same time as the charges are reflected in prices charged to sites connected to Gas Distribution Networks.

This Modification Proposal does not conflict with:

- (i) paragraphs 8, 9, 10 and 11 of Standard Condition 4B of the Transporter's Licence; or
- (ii) paragraphs 2, 2A and 3 of Standard Special Condition A4 of the Transporter's Licence;

## 5 Implementation

No implementation timescales are suggested at this time. Wales & West Utilities will discuss this through the Workgroups.

No implementation costs are anticipated.

## 6 Legal Text

Much of the legal text for 0517 can be re-used but further text will be required to implement the additional provisions of 0517A with regard to notice periods and the model to be used during such notice periods.

## 7 Recommendation

The Proposer invites the Panel to:

- Progress to Workgroup assessment.