

To shippers, network companies,  
suppliers, consumers and their  
representatives and other  
interested parties



Making a positive difference  
for energy consumers

---

Direct Dial: 020 7901 7159  
Email: [andy.burgess@ofgem.gov.uk](mailto:andy.burgess@ofgem.gov.uk)  
Date: 24 June 2013

## **GAS TRANSMISSION CHARGING REVIEW – CALL FOR EVIDENCE**

Today we are launching our Gas Transmission Charging Review (GTCR) and we are seeking your views. The review will look at the way in which all of the entry and exit charges on the National Transmission System (NTS) are set. The main reasons prompting us to undertake this review are below.

- Many stakeholders are concerned that a key element of gas transmission charges – so called 'commodity charges' - have been increasing in recent years.
- Charging arrangements tend to discourage the import and encourage the export of gas<sup>1</sup>. This has potential security of supply implications. Our review will consider this issue and will explore how these concerns can be addressed.
- Developments in European law mean we expect there will need to be major changes to the charging arrangements at the points that our network interconnects with the networks of other countries. A key question is whether charging arrangements ought to change at other points in our network too.
- We want to make sure that transmission charges protect the interests of gas consumers and provide the right incentives for industry.

This open letter is a first step in the process of stakeholder engagement. It invites views on the scope of and priorities for the review and calls for evidence from all interested parties. We welcome responses by the end of **Monday 16 September 2013**. In order to facilitate engagement with our call for evidence we also intend to hold a meeting to launch this work on **Monday 8 July 2013**.

Further information on the background to our review, our objectives, what we are seeking from you and our next steps is provided below.

---

<sup>1</sup> [http://www.ofgem.gov.uk/Europe/Documents1/120928\\_Interconnector\\_Open%20Letter%20Final.pdf](http://www.ofgem.gov.uk/Europe/Documents1/120928_Interconnector_Open%20Letter%20Final.pdf)

## Background

The key reasons prompting us to undertake this review are explained in more detail below.

**Stakeholders' concerns about the growing level of the Transmission Owner (TO) entry commodity charge.** National Grid Gas (NGG) seeks to recover 50 per cent of its allowed revenue for the NTS from entry charges. These charges are made up of capacity charges and commodity charges. In recent years, capacity bookings and usage have been falling and this has led to a declining trend in revenues raised from the sale of entry capacity. The resulting under-recovery has led to increasing TO entry commodity charges which are now substantial.

**Cross-border flows.** The impact of the entry commodity charge was highlighted by stakeholders following our open letter on gas interconnector flows and their price responsiveness<sup>2</sup>. Entry commodity charges discourage the import and encourage the export of gas from Great Britain to the continent.

**European developments.** European network codes are being agreed in order to provide and manage effective and transparent access to the transmission networks across European borders. These network codes are European law<sup>3</sup> which will need to be implemented in Great Britain. Ofgem, as the National Regulatory Authority for Great Britain<sup>4</sup>, under the Third Package has the task of overseeing compliance by gas undertakings with the Gas Regulation including their obligations under the network codes.

The network codes are expected to change the charging and capacity allocation arrangements at interconnection points (ie Bacton and Moffat). This will require capacity to be bundled together at interconnection points along with interconnection capacity and neighbouring entry/exit capacity for auction on a European platform. We expect that network costs at interconnection points will need to be recovered through capacity prices in auctions without any additional charges (such as commodity charges).

A key question for us to consider is how to avoid unduly inconsistent charging arrangements across the network which might inhibit competition and so harm security of supply and affordability.

**The need to ensure incentives are right.** The current charging arrangements have been in place for several years. Exit reform took effect from October 2012 and introduced a common booking process and standardised national transmission system (NTS) exit capacity products for NTS users. The RIIO-T1 price control has set the allowed revenues for NGG for the next eight years. It is timely to review the system of charges NGG applies in order to recover revenues from users and to consider whether it is best calculated to further our principal objective to protect the interests of existing and future gas consumers.

Further background information is in the annexes. *Annex 1* gives an overview of the current charging arrangements, including a summary description of NGG's transportation model which is used to generate capacity charges at entry and exit points. *Annex 2* describes recent trends in the pattern of capacity bookings and charges and explains in broad terms why commodity charges have needed to increase in recent years. *Annex 3* summarises the

---

<sup>2</sup> [http://www.ofgem.gov.uk/Europe/Documents1/120928\\_Interconnector\\_Open%20Letter%20Final.pdf](http://www.ofgem.gov.uk/Europe/Documents1/120928_Interconnector_Open%20Letter%20Final.pdf)

<sup>3</sup> Network codes are annexes to the Third Package Gas Regulation ie (EC) No 715/2009 of the European Parliament and of the Council of 13 July 2009 on conditions for access to the natural gas transmission networks and repealing Regulation (EC) No 1775/2005.

<sup>4</sup> Under section 3A(1) of the Utilities Act 2000, as amended, the Authority is designated as the regulatory authority for Great Britain in accordance with Article 35 of the Electricity Directive and Article 39 of the Gas Directive.

interaction between transmission charges and cross-border flows. *Annex 4* gives an overview of the relevant European network codes and their potential interaction with GB transmission charging arrangements. Finally, *Annex 5* gives an overview of NGG's licence objectives in relation to its charging methodology and Uniform Network Code (UNC) modifications.

## **Our objectives**

Our key aim in this review is to protect the interests of existing and future consumers<sup>5</sup>. Therefore we are ensuring GB's gas transmission charging arrangements play their part in promoting security of supply and value for money for consumers, whilst furthering the objectives set out in the Gas Directive as well as promoting compliance with forthcoming network codes (and other European and domestic law).

As guiding principles, we consider that, in general, charging arrangements will tend to promote our aims where they are cost-reflective, promote efficiency and promote competition. As such, charges should also be non-discriminatory, transparent and as stable as possible and, so far as possible, eliminate restrictions on trade between Member States.

We would expect there to be net benefits for users where charging arrangements are consistent with these guiding principles, eg charges that are cost reflective will tend to create the right signals to ensure that unnecessary costs are avoided. That said, since charges need to allow NGG to recover its efficiently incurred costs in respect of its NTS business there are also likely to be trade-offs. For example, lowering some charges probably means increasing some other charges. There may also be trade-offs in promoting investment compared to promoting access.

Our objective for this project is to ensure that the structure of GB transmission charges protects the interests of future and existing consumers by:

- setting the right incentives for all parties
- ensuring that GB transmission charges are compliant with emerging European network codes and Framework Guidelines<sup>6</sup>
- ensuring that our approach to GB transmission charges at interconnection points and domestic points avoids any undue distortions.

## **What are we seeking from stakeholders?**

We are seeking your views to help us understand all the relevant issues (eg your concerns with charging arrangements), to help us establish our objectives and priorities, and to help us develop options.

---

<sup>5</sup> Our principal objective, as set out under section 4AA of the Gas Act is to protect the interests of existing and future consumers in relation to gas conveyed through pipes. Those interests are taken as a whole and include their interests in the reduction of gas supply emissions of targeted greenhouse gases, the security of supply of gas to them and their interests in the fulfillment by us, when carrying out our functions as a designated regulatory authority for Great Britain, of the objectives set out in Article 40(a) to (h) of the Gas Directive. These objectives include promoting a competitive internal market, developing competitive and properly functioning regional markets and eliminating restrictions on trade between Member States.

<sup>6</sup> Framework Guidelines are issued by the European Commission under the Gas Regulation and set out the basis for the development of network codes. Network codes are required to be in line with the relevant Framework Guideline.

We welcome views on aspects of the transmission review that you consider should shape its direction. That said, we also believe it is helpful to say what is out of scope of the review. Connection charges and connection arrangements for incremental capacity are out of scope of the review. We also cannot revisit the RIIO-T1 price control.

Where possible, we ask you to provide evidence, eg analysis and examples. While we have put the questions in order to elicit responses in a structured way, we would welcome all views relating to gas transmission charging arrangements. Our questions are below.

### *Understanding the issues*

- Question 1: What has given rise to the current balance between charges for access to the transmission network? How might this change in future?
- Question 2: What issues are there with current charging arrangements? For example:
  - Does the charging structure strike the right balance between incentives to use capacity efficiently and investment?
  - Is capacity available when needed?
  - Do charging arrangements help NGG to plan network investment?
  - How do our current charging arrangements interact with those in neighbouring markets? What is the impact of these interactions?
- Question 3: How do current arrangements give rise to these issues?
- Question 4: In the event that there were to be minimal implementation of the Framework Guidelines/network codes as currently drafted, eg no subsequent changes at domestic points, what would be the impact?

### **Establishing our priorities for the review**

- Question 5: Are our goals for the review appropriate?
- Question 6: How could charging arrangements better meet the objectives set out in NGG's special standard condition A5<sup>7</sup> which sets out the objectives for NGG's charging methodology?
- Question 7: Do the objectives set out in NGG's special standard condition A5 remain fit for purpose? If not, how should they be changed?
- Question 8: What other suggestions do you have for the objectives of our review?
- Question 9: What is your view on the timescale for our review?

---

<sup>7</sup> See Annex 5

## **Our options**

- Question 10: Bearing in mind the issues and objectives you have identified, what options should be explored to address these?
- Question 11: What are the pros and cons of your suggested option?

## **Next Steps**

We will keep you informed and will publish relevant information on our website when appropriate.

We welcome responses to this call for evidence by the end of **Monday 16 September 2013**. All responses will be placed on our website unless marked as confidential. Please email your response to [david.beaumont@ofgem.gov.uk](mailto:david.beaumont@ofgem.gov.uk)

In order to facilitate engagement with our call for evidence we intend to hold a event to launch this work on **Monday 8 July 2013**. Attendees will be given background information and will be able to ask questions about the review. Any views expressed at the meeting may feed into our thinking but will not be considered formal responses to our call for evidence. In order to promote transparency we will publish a note of the meeting along with the materials presented at the meeting on our website afterwards. If you would like to attend please contact [aled.moses@ofgem.gov.uk](mailto:aled.moses@ofgem.gov.uk) by the end of Friday 28 June 2013.

Following the close of our call for evidence and publication of non-confidential responses we will inform stakeholders of how we propose to take forward this work.

If you have any questions or comments on the content of this letter, please contact Alex Whitmarsh in the first instance at [alex.whitmarsh@ofgem.gov.uk](mailto:alex.whitmarsh@ofgem.gov.uk)

Yours faithfully,

**Andy Burgess**  
**Associate Partner, Transmission and Distribution Policy**

## ANNEX 1 – OVERVIEW OF CURRENT CHARGING ARRANGEMENTS

### *How are users charged?*

- A1.1. Charges for access to the National Transportation System (NTS) are based on a system of entry-exit charges. The methods and principles on which Transmission transportation charges are derived are set out in the Uniform Network Code (UNC) – Transportation Principal Document (TPD)<sup>8</sup>.
- A1.2. Transmission charges are set in order to recover Transmission Owner (TO) and System Operator (SO) allowed revenues. Aside from certain specific charges, the aim is that 50 per cent of allowed TO revenues are recovered from TO entry charges and the other 50 per cent is recovered from TO exit charges. The SO commodity charge on entry and exit is identical.

### *Capacity Charges*

- A1.3. **TO Entry capacity charges:** System Entry Capacity (SEC) is allocated by means of five principal auctions:

- quarterly (firm) – ‘QSEC’
- monthly (firm) – ‘MSEC’
- rolling Monthly Transfer and Trade (firm) – ‘RMTTSEC’
- daily (firm) – ‘DSEC’
- daily Interruptible (DISEC)

- A1.4. The reserve prices for each of these products are calculated each year using the NTS Transportation model (outlined below). In order to promote the efficient use of the system discounts to the MSEC reserve prices are applied to some products as follows:

- 33.3 per cent for Day Ahead Daily (firm) – ‘DADSEC’
- 100 per cent for Within Day Daily (firm) – ‘WDDSEC’
- 100 per cent for Daily Interruptible – ‘DIDSEC’

- A1.5. **TO Exit capacity charges:** Exit capacity is allocated by means of four capacity products:

- enduring Annual NTS Exit (Flat) capacity
- annual NTS Exit (Flat) capacity
- daily Firm NTS Exit (Flat) capacity and
- daily Off-Peak NTS Exit (Flat) capacity

- A1.6. The Enduring Annual and Annual products are allocated through application windows. The Daily Firm and Off-Peak products are released through auctions.

- A1.7. Reserve prices for the Daily Firm capacity auctions are equal to the Enduring Annual/Annual capacity charges (outlined below). The reserve price for Off-Peak Daily capacity, which is auctioned on a daily day-ahead basis, is zero.

---

<sup>8</sup> [www.gasgovernance.co.uk](http://www.gasgovernance.co.uk)

## *Commodity Charges*

A1.8. Commodity charges consist of charges per unit of gas transported at exit and entry points. Commodity charges for NTS storage facilities are zero, apart from the gas used as part of the operation of any NTS Storage facility ('own use' gas).

A1.9. Commodity charges can be split into the categories below.

- TO Entry Commodity Charge. This charge is levied at entry points where National Grid forecasts that the entry capacity auction revenue will be below the target revenue.
- TO Exit Commodity Charge. This charge is levied at exit points where National Grid forecasts that the exit capacity revenue will be below the target revenue.
- SO Entry and Exit (Flat) Commodity Charge. These charges are applied uniformly on both entry and exit flows at all NTS system points in order to recover allowed SO revenues.

A1.10. Shippers may elect to pay the optional 'short-haul' commodity charge as an alternative to the other commodity charges. This charge is derived from the estimated cost of laying and operating a dedicated pipeline of NTS specification. The way in which the charge is calculated means that in practice shippers are only likely to opt to pay the optional short-haul commodity charge if they have relatively large supply points situated close to a terminal.

## *Transportation Model*

A1.11. NTS capacity charges (ie reserve prices at entry points and capacity charges at exit points) are calculated through the NTS Transportation Model. This model has two components.

A1.12. **The transport component of the model.** This calculates the Long Run Marginal Cost (LRMC) of transporting gas from each entry point to a 'reference node' and from the 'reference node' to each offtake point. Generally, the further the entry or exit point is from the reference node the higher the LRMC estimate. However, where a change in a flow from an entry or exit point would reduce flows from another part of the network (eg an increase in flow from an entry point within a 'deficit' region would reduce the need to transport gas from a surplus region) then this will tend to reduce the LRMC estimate at this point. The network is assumed to be 100 per cent utilised, ie no ullage is assumed.

A1.13. The unit costs which underpin the LRMC estimates are based on the physical distance between the entry/exit point multiplied by an 'expansion factor' which is an estimate of building additional NTS capacity of a given length of pipe.

A1.14. **The tariff component of the model.** The Tariff Model takes the LRMC estimates from the Transport Model and adjusts them in a number of ways in order to derive entry capacity reserve prices and exit charges. The adjustments include:

- to help ensure an equal split of costs between entry and exit, an adjustment factor is applied to make the sum of entry LRMCs and exit LRMCs equal, and

- simultaneously removes negative marginal distances – ensuring that no point faces negative charges, then
- for entry charges, adjusts forecasts flows through an iterative process assuming that each entry point flows at its obligated capacity level
- for exit charges, applying an additive constant (the 'Revenue Adjustment Factor') with the aim of that if all baseline capacity were to be sold exit charges would recover allowed TO exit revenue.

A1.15. The reasons why this approach does not ensure revenues from capacity sales match allowed revenue is described below.

A1.16. **Entry capacity.** Although there is some adjustment to entry LRMCs to bring them into line with the LRMCs of exit at an aggregate level this doesn't ensure capacity revenues are close to allowed revenues.

A1.17. TO entry capacity charges are held constant in nominal terms (i.e. there is no adjustment for inflation) and do not vary over the period the products are being auctioned, eg the reserve price for a quarter two years ahead and a quarter 15 years ahead are the same. Unlike exit capacity charges, TO Entry reserve prices are not calibrated in order to help bring capacity revenues closer to the allowed entry revenue.

A1.18. **Exit capacity.** In accordance with the UNC TO exit capacity charges are set in the July<sup>9</sup> before the gas year in which they apply. Although NTS Exit (Flat) capacity charges are calibrated to some degree by applying the 'Revenue Adjustment Factor' under-recovery may result if not all baseline capacity is sold. The introduction of an Off-Peak (interruptible) product means some capacity may be sold below the level of annual capacity charges. Any shortfall is made up with the NTS TO Exit Commodity Charge.

---

<sup>9</sup> The UNC requires that two months notice is given for Final Charges. From May 2012 NTS Exit (Flat) Capacity charges have been sent at the beginning of May to give 150 days notice of actual charges.



## ANNEX 2 – RECENT TRENDS IN THE PATTERN OF CAPACITY BOOKINGS AND CHARGES

A2.1. The existing regime in which shippers have been able to buy quarterly, monthly and daily rights to capacity in a number of auctions (see *Annex 1* for more details) has been in place since 2003. The introduction of the annual QSEC auction which offered capacity up to 17 years ahead of the auction represented a substantial increase in the time-period over which capacity could be booked. Due to the length of the booking period QSEC has been the primary way of obtaining capacity for shippers wishing to have firm rights.

A2.2. Competition for long-term capacity appears to be falling. We note:

- Total sales (over the 15 year allocation period) of QSEC capacity is falling year-on-year (see figure 1 – i.e. Volume sold column)
- QSEC capacity is being bought by a declining number of shippers year-on-year (see figure 1)
- In 2012 and 2013 all capacity was sold at the reserve price

*Figure 1: N-Firm concentration ratios for sold capacity in each annual QSEC for all years*

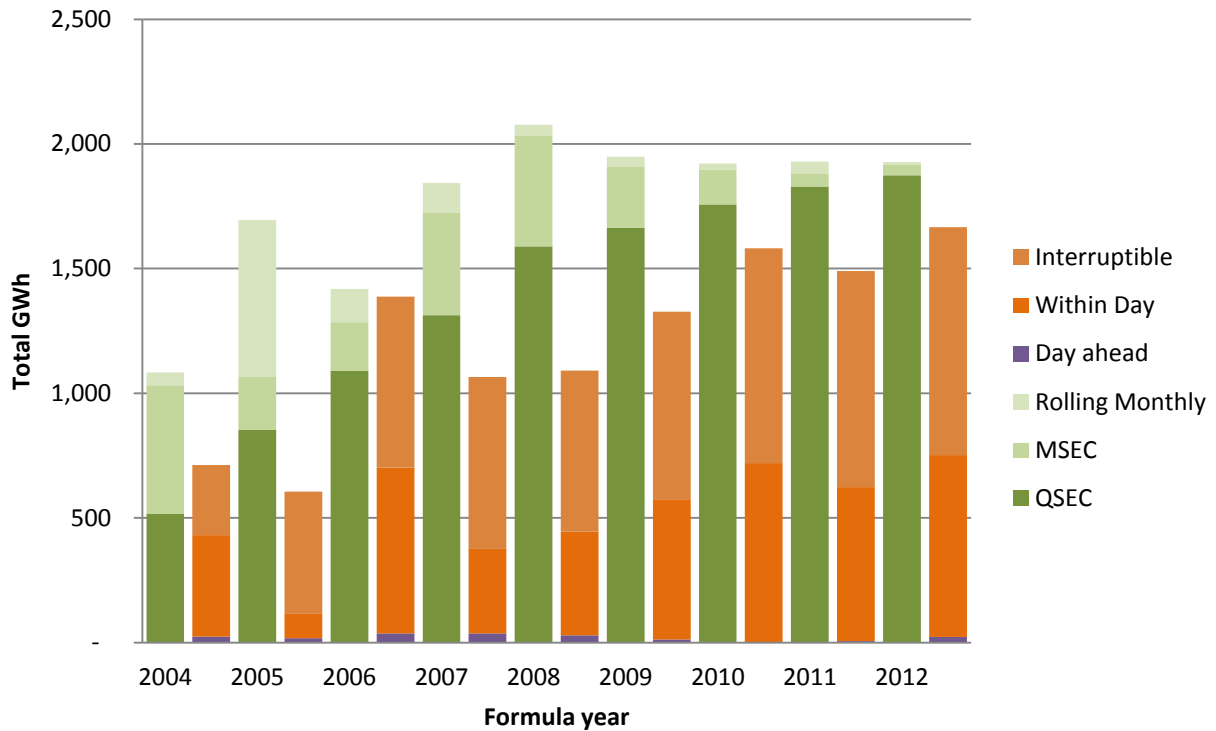
QSEC auction	Volume Sold (TWh)	Number of Shippers buying capacity	Share of Sold Volume bought by top three shippers (%)	Share of Sold Volume bought by top five shippers (%)
2006 (Sep)	7,740	19	57	80
2007 (Sep)	3,374	25	70	83
2008 (Sep)	2,523	22	63	75
2009 (Sep)	2,307	12	80	89
2010 (Mar)	1,310	19	68	80
2011 (Mar)	1,428	17	65	77
2012 (Mar)	1,133	13	75	91
2013 (Mar)	643	11	60	83

*Source: National Grid. Note that volume is reported as originally calculated in TWh (this allows for the different days in each month in each quarter),*

A2.3. For any formula year the volume and value of quarterly sales is determined by past auctions, but the trends in long term sales shown in Figure 1 are mirrored in annual QSEC revenues which are forecast to fall by 25 per cent from the recent peak in 2011/12 to 2014/15.

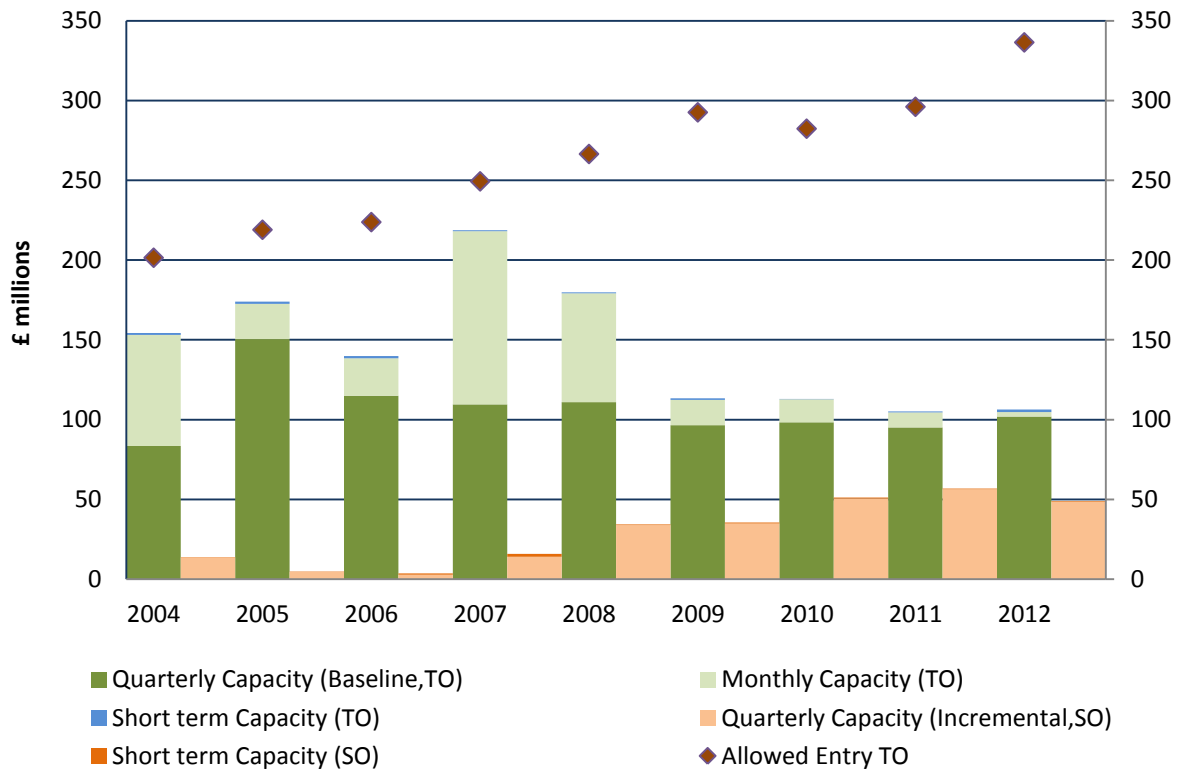
A2.4. Figure 2 illustrates the volume of capacity sales by product with separate columns for medium/long term capacity and short term capacity. This highlights the volume of capacity made available through within day firm sales has been variable over the period considered. Sales of interruptible capacity have been relatively steady.

Figure 2: Volume of capacity sales



Source: National Grid

Figure 3: Formula year revenue by capacity type

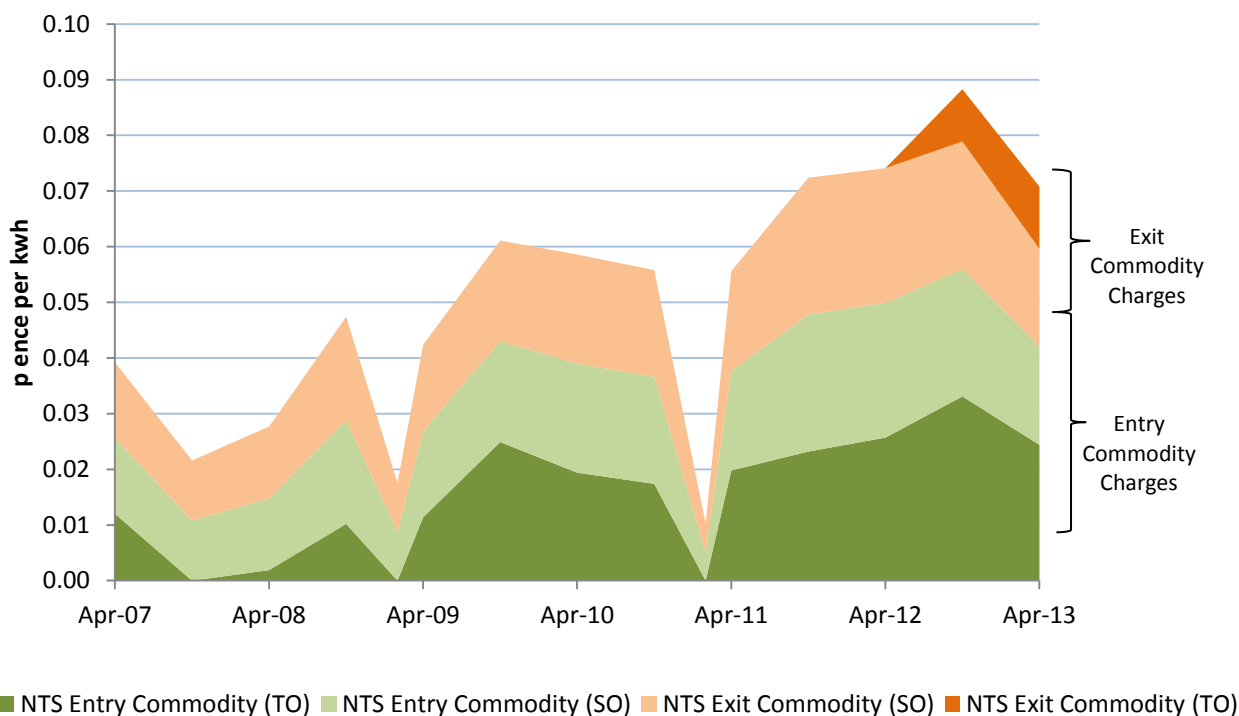


Source: National Grid

A2.5. Figure 3 illustrates the earned revenue<sup>10</sup> for each formula year by capacity type. In other words, it records the amount that would be invoiced by NGGT for that capacity year. The revenues going to the Transmission Owner and System Operator are shown on different bars.

A2.6. The majority of revenues from capacity sales come from long term capacity (eg QSEC) rather than short term capacity. Baseline revenue from QSEC and MSEC peaked in 2005 and 2007, respectively.

Figure 4: TO and SO Commodity Charges. April 2007 until April 2013



Source: National Grid

### Commodity charges

A2.7. TO entry commodity charges need to make up the difference between the revenues from TO entry capacity sales and allowed TO revenue. The recent downward trend in revenues from TO entry capacity sales has led to increases in TO commodity charges. Figure 4 shows how the level of commodity charges has generally been on an upward trend, albeit:

- there were drops in February 2009<sup>11</sup> and February 2011<sup>12</sup>, each representing a third price change in the commodity charge for the respective formula years to ensure that an over recovery was avoided and not overcharging shippers
- commodity charges fell in April 2013 principally as a result of the lower allowed revenues arising from RIIO-T1.

<sup>10</sup> Where the revenue equates to the booking multiplied by the reserve price or final clearing price as appropriate.

<sup>11</sup> For February 2009, the change was required due to a reduction in shrinkage costs, more than was anticipated earlier in the formula year and increased volumes being charged this normal commodity over the Optional Commodity rate.

<sup>12</sup> For February 2011, the change was as a result of reduced shrinkage costs due to declines in underlying UAG and credits from meter error reconciliations.

### **ANNEX 3 – THE INTERACTION BETWEEN TRANSMISSION CHARGES AND CROSS-BORDER FLOWS**

- A3.1. Initial analysis undertaken by the Belgian regulator (Commission de Régulation de l'Électricité et du Gaz), the Dutch regulator (Authority for Consumers and Markets - ACM) and us suggested that:
- gas flows between GB and the continent did not always go to the market with the highest price
  - utilisation rates on the interconnectors was low.
- A3.2. Our open letter published in October 2012 consulted stakeholders on our initial analysis and what more could be done to remove barriers to cross-border trade.
- A3.3. The interaction between our charging arrangements and those on the continent encourages the export of gas originating from the Southern North Sea and the BBL pipeline which lands at Bacton<sup>13</sup>. This is because (where shippers have already acquired the necessary capacity rights) they can either pay the entry commodity charges to enter gas into the GB gas network or alternatively pay a short-haul tariff, the IUK fuel charges and then flow gas to the Zeebrugge hub to get gas into the Belgian system. Since the commodity charge is around 1.4 pence per therm higher than the Short Haul Tariff payment and IUK fuel charges, wholesale prices in GB need to be around 1.4 pence per therm higher than those in Belgium in order to prevent this from occurring.
- A3.4. The feedback to our open letter on interconnector flows, and our own internal analysis, has indicated that the GB commodity charge discourages the import and encourages the export of gas. The Gas Transmission Charging Review provides an opportunity to explore the affect of the commodity charge and consider other ways of recovering revenues that do not affect interconnector flows.

---

<sup>13</sup> This does not apply to gas already within the GB system.

## **ANNEX 4 - AN OVERVIEW OF THE EUROPEAN NETWORK CODES AND THEIR POTENTIAL INTERACTION WITH GB TRANSMISSION CHARGING ARRANGEMENTS**

- A4.1. The Third Package Gas Regulation requires a number of network codes to be developed for issues relating to the transport of gas across borders in Europe. European network codes are either new regulations or annexes to the Third Package Gas Regulation. These network codes are European legislation which will need to be implemented in Great Britain (GB). The network codes will, amongst other things, impact on the GB charging arrangements.
- A4.2. The Capacity Allocation Mechanisms (CAM) network code was agreed by Member States recently and is due to come into force as a Regulation later this year. This requires to be implemented by November 2015. The responsibility for implementing the network code in GB is for the Member State (DECC). Ofgem as the National Regulatory Authority (NRA) for GB under the Third Package has the task of ensuring that gas undertakings comply with the Gas Regulation including their obligations under the network code.
- A4.3. The main aspects of the CAM network code will be that cross-border firm capacity will be bundled (to move gas from transmission system operator (TSO) A to TSO B only one capacity product will be required not separate TSO A exit capacity and TSO B entry capacity as currently required). This bundled firm capacity will be allocated in products with standard durations (annual, quarterly, monthly, day-ahead and within-day) by means of auction.
- A4.4. The auctioning of standard bundled capacity raises a number of questions on charging. These charging questions will be addressed in the network code on Tariffs. The tariff network code will address the questions of:
- What is the auction reserve price for a bundled annual capacity product?
  - What is the relation between the reserve prices for the bundled annual capacity product and short-term / interruptible capacity?
  - What price do users pay for capacity that is auctioned long-term (ie is the price payable set at auction or nearer to the time of use)?
  - How is auction revenue from the sale of bundled capacity are shared between TSOs?
  - How do TSOs recover their allowed revenues?
- A4.5. Currently the tariffs work is at an earlier stage than CAM. The Agency for the Cooperation of Energy Regulators (ACER) is developing the high level principles on the basis of which the tariffs network code will be required to be drafted (the Framework Guidelines). ACER has been developing the Framework Guidelines for tariffs since 2012 and has endorsed around 80 per cent of the Framework Guidelines policy. ACER aims to finalise the outstanding section on cost allocation (cost allocation is the process of going from the allowed revenues to the value of the annual capacity tariff for each point on the network) by the end of 2013 and submit the Framework Guidelines to the European Commission. Once the European Commission is content with the Framework Guidelines it will give the European Network of TSOs for Gas (ENTSOG) one year to develop the tariff network code

which will then need to be approved by ACER and then the European Commission and adopted by the European Commission. The tariff network code is scheduled to be implemented by October 2017, however, it does not stop aspects of the network code from being implemented early or taking transitional steps towards implementation for October 2017<sup>14</sup>.

- A4.6. The endorsed sections of the Framework Guidelines would have a number of impacts on the GB charging regime if it remains that way. These are set out below.

#### *Short-term reserve prices*

- A4.7. The endorsed Framework Guidelines if they remain the same would require that at interconnection points day-ahead and within-day capacity is charged at a price equal to or less than the annual reserve price (in terms of p/KWh/day) unless the NRA decides to charge a higher price (subject to limits) where there is no congestion<sup>15</sup>. Before adopting the decision for how to price bundled short-term capacity neighbouring NRAs should account for each others' views. As NGG currently offers discounts for day-ahead and within-day capacity so would be compliant, however, as NGG will be offering capacity as part of a bundled product with neighbouring TSOs the NRAs involved will have to account for each others' views.
- A4.8. The endorsed Framework Guidelines if they remain the same would require that at interconnection points interruptible capacity is set at a discount to the firm capacity. The Framework Guidelines require ENTSOG to develop a more detailed methodology for setting the price for interruptible capacity such that for bi-directional interconnection points the discount reflects the likelihood of interruption (with a low risk of interruption incurring a small discount) and for the discount to be recalculated once per year. Whilst for unidirectional interconnection points the price for backhaul interruptible product will reflect the actual marginal (additional cost) for the TSO to provide the service (with a minimum price of zero). As the development of the network code has not started it is difficult to assess the impacts on NGG's charging regime for this issue. Furthermore there is a requirement in the CAM that TSOs offer a daily interruptible capacity where firm capacity has sold out at the day-ahead stage and interruptible products of other standard durations may also be offered. The CAM requires that all interruptible capacity is auctioned except within-day capacity which, where it is offered, will be allocated by means of shippers nominating above their existing capacity holdings (and as interruptible capacity is interrupted based on the last capacity bought being interrupted first, this effectively is a first come first served allocation mechanism).

#### *Payable price*

- A4.9. The endorsed Framework Guidelines if they remain the same would require that at interconnection points the price paid for capacity bought in previous years through the long-term auctions would be set in the year of use of the capacity (specifically the reserve price of the annual capacity product in the year of use plus any auction premium that the capacity was allocated at). The impact on NGG would be that the price to be paid for entry capacity at Bacton bought in previous years and for use

---

<sup>14</sup> Although there is the possibility to extend or defer by a year on specific circumstances.

<sup>15</sup> Contractual congestion is where network users cannot gain access to gas transmission systems in spite of the physical availability of capacity

post October 2017 would not be at the price agreed at the auction and would need to change (as currently the price is set at the time of auction not the time of use).

#### *Sharing of revenues from bundled capacity*

A4.10. The endorsed Framework Guidelines if they remain the same would require that at interconnection points the bundled reserve price is the sum of the reserve price of the individual TSOs' capacity that make up the bundled product. They also require that in terms of auction revenues the receipt of the bundled reserve price as revenue for the sale of a unit of bundled product will be redistributed amongst the relevant TSOs so that each receives its individual reserve price. Any premium above the bundled reserve price that the capacity was allocated at in the auction will be shared amongst relevant TSOs according to the agreement between NRAs. However, if no agreement is reached the default will be an equal share of the auction premium between TSOs.

#### *Revenue recovery*

A4.11. The endorsed Framework Guidelines if they remain the same would require that any over- or under-recovery of allowed revenues is put into a pot ("regulatory account" or the "K-factor" in GB terminology). Then at the end of a period (the length in years to be determined by the NRA) the outstanding amount is recovered by allocating to be recovered from each entry and exit point according to the share in the chosen cost allocation methodology (this methodology is still subject to the work being carried out by ACER in 2013) and therefore varying the price of the annual capacity product. The endorsed Framework Guidelines allow for two deviations from this. The first is that NRAs can decide to use a different revenue recovery mechanism for non-interconnection points. The second is that over- or under-recoveries of costs driven by flows, which are recovered through a flow based charge, can be recovered by a variation of the flow based charge.

A4.12. The impact on NGG is that at the interconnection points the TO commodity charge (as a revenue recovery mechanism) would not be possible to use. The further question remaining is whether the approach in the framework guideline should be adopted at all points on NGG's network.

#### *Setting of annual reference price*

A4.13. The endorsed Framework Guidelines if they remain the same would require that setting the reserve price of the annual capacity charge should be done so that the under- or over-recovery is minimised. The impact on NGG is that the entry capacity reserve prices would have to be set to recover allowed revenues (which is currently done by NGG for exit).

## **ANNEX 5 – CHARGING METHODOLOGY AND UNC OBJECTIVES**

A5.1. The GB gas transmission charging arrangements are contained in the Uniform Network Code (UNC). Section Y of the UNC sets out the methodology by which NGG determines charges (the 'charging methodology'). NGG has an obligation to ensure the charging methodology continues to achieve the relevant charging methodology

objectives, which can be found in paragraph A5.3 below. Any changes to the charging methodology through the UNC modification process must better facilitate these objectives.

A5.2. There may be instances where modifications to the overall gas transmission charging framework might also require changes to sections of the UNC other than Section Y. In this event, these changes will need to be considered against the relevant UNC objectives, which are set out in paragraph A5.4 below.

#### *Charging methodology objectives*

A5.3. Paragraph 5 of Standard Special Condition A5 of NGG's gas transporter licence sets out the relevant methodology objectives with which the gas transmission transportation charging methodology must conform. These are:

(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;

(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); and

(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.

#### *UNC objectives*

A5.4. Paragraph 1 of Standard Special Condition A11 of NGG's gas transporter licence sets out the relevant licence objectives in relation to the UNC. These are:

(a) The efficient and economic operation of the pipeline system to which the NGG NTS licence relates;

(b) So far as is consistent with sub-paragraph (a), the coordinated, efficient and economic operation of (i) the combined pipe-line system, and/or (ii) the pipe-line system of one of more other relevant gas transporters;



- (c) So far as is consistent with sub-paragraphs (a) and (b), the efficient discharge of the licensee's obligations under the licence;
- (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 GDN operators (who have entered into transportation arrangements with other relevant gas transporters) and relevant shippers.
- (e) So far as is consistent with sub-paragraphs (a) to (d), the provision of reasonable economic incentives for relevant suppliers to secure that the domestic customer supply security standards are satisfied as respects the availability of gas to their domestic customers;
- (f) So far as is consistent with sub-paragraphs (a) to (e), the promotion of efficiency in the implementation and administration of the network code and/or the uniform network code;
- (g) compliance with the [Gas] Regulation and any relevant legally binding decisions of the European Commission and/or the Agency for the Co-operation of Energy Regulators; and
- (h) in relation to:
  - (i) the connection charging methodology, the relevant objectives listed in paragraph 5 of Standard Condition 4B; or
  - (ii) the charging methodologies regulated by Standard Special Condition A5, the relevant objectives listed in paragraph 5 of Standard Special Condition A5