Energy UK

The voice of the energy industry

Gas Transmission Charging Review – Call for Evidence

Consultation Response

Energy UK is the Trade Association for the energy industry. Energy UK has over 70 companies as members that together cover the broad range of energy providers and suppliers and include companies of all sizes working in all forms of gas and electricity supply and energy networks. Energy UK members generate more than 90% of UK electricity, provide light and heat to some 26million homes and last year invested over £10billion in the British economy.

Energy UK welcomes the opportunity to provide comments to this consultation to this call for evidence. We provide a brief summary of key points and more detailed comments to the questions below.

- Concern over the uncertainty this review could create
- Caution the risk of unintended consequences of a wide ranging review.
- Predictability of charging arrangements and charges is important
- Attractiveness of GB market should be maintained
- Ofgem should undertake more analysis.

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?

The current charging methodology has given rise to the current balance of charges with TO entry capacity income accounting for around 50% of TO entry revenue, with most of this being from QSEC auctions. We observe that revenue from QSEC bookings appears to have been relatively stable for a number of years but that allowed revenue at entry has increased by >50% over the last nine years. Also that over this period the volume of QSEC bookings seems fairly stable at around 50% of total volume booked, with there being a reduction in MSEC bookings reflected in an increase in within day bookings. Daily interruptible volumes also appear to be fairly stable.

The balance of charges between capacity and commodity at entry has arisen due to there being adequate entry capacity at a time of declining domestic production coupled with short term entry capacity being available at the short run marginal cost, a substantial discount from the QSEC reserve price.

Looking forward this balance of charges may persist or could change if new entry points are developed and if substitution leads to the re-distribution of surplus entry capacity, which in itself creates and incentive to encourage longer term bookings.

Question 2: What issues are there with current charging arrangements?

There are a range of views on whether there are issues with the arrangements or not. These views range from there being no particular concerns as the market is functioning well, including cross border flows through to views on the lack of certainty over entry charges hindering gas being landed in GB. The balance of views seems to reflect a downstream / upstream split, with the main focus of differences in views being in relation to short-term bookings and the influence this has on TO entry commodity charges. We also note that SO commodity charges tend to be quite variable with changes not always well signalled in advance. We consider that National Grid could do more to flag changes in commodity charges.

There are multiple inter-related issues and it is difficult if not impossible for charging arrangements and the charges themselves to simultaneously meet all the objectives as listed in Regulation 1775/2009. These include being non-discriminatory, reflecting costs incurred, facilitating efficient trade and competition whilst also avoiding cross subsidies between network users. We would welcome from Ofgem some clarity on the hierarchy of these objectives.

o Does the charging structure strike the right balance between incentives to use capacity efficiently and investment?

The charging structure cannot be viewed in isolation from the capacity allocation arrangements; it is the combination of the two that determines efficient use of capacity and investment in infrastructure.

In GB we use a forward looking LRMC methodology which leads to geographic differentiation in entry and exit prices, this gives an indication of where it would be most cost effective, from the operators perspective, to connect new supplies to the network. However in reality new entry connections do not have complete freedom as to where they connect as this will be heavily influenced by other physical parameters. E.g. deep water port locations for LNG importation and availability of cooling water and electricity grid connection for gas- fired generation. Therefore the price of entry or exit capacity is only one relatively minor input parameter affecting investment decisions, wider issues such as the planning regime for nationally significant projects, and EMR capacity mechanism will be important alongside the capacity booking regime which is being reviewed by UNC Modification Proposal 452.

The current arrangements also allow for entry capacity charges to be fixed at the time of booking at a QSEC auction over an extended period; this assists investment decisions associated with incremental capacity bookings. This certainty would be lost if the EU network code on tariff harmonisation were extended to GB domestic points in addition to Interconnection Points (IPs).

With respect to use of capacity, having ‘spare’ capacity available for short-term bookings at a discounted or a zero price encourages the efficient use of the system. However, we do recognise that this does not assist with achieving revenue recovery.

o Is capacity available when needed?

Yes, the GB network is relatively unconstrained and aggregate entry baselines are well above peak day demand, this allows flexibility in where gas can be landed.

The charging structure and allocation arrangements allow a choice to be made between long-term and short-term bookings or any combination thereof. Shippers value these options as the options are well matched to a variety of business models and meet shippers’ needs for longer term, flat, profile as well as shorter term requirements, so yes capacity is generally available when needed.

There are different views on whether the non- geographic TO entry/exit commodity charge is appropriate at the current level, particularly as it is payable by all shippers. This depends on whether short-term bookings at the short run marginal costs are seen as promoting efficient use of the network or whether higher capacity charges for all users would be an acceptable alternative. Since the revenue needs to be recovered by some mechanism it is difficult to assess the impact on customer tariffs of different tariffs structures, but it would be important to consider this if changes were to be considered.

o Do charging arrangements help NGG to plan network investment?

National Grid is probably best placed to answer this, since industry does not have full transparency over National Grid's investment decision process. Shippers provide signals for incremental capacity, via the auction and/or application windows. National Grid considers a number of options for delivering the capacity before potentially putting forward an investment case to Ofgem for approval.

However the linkage between the charging arrangements and network investment, where the network has adequate capacity is not apparent. We anticipate in the future any investment is likely to be driven by discrete projects rather than incremental capacity needs at existing points. As such the dominant investment driver will be other factors rather than the entry or exit charge.

o How do our current charging arrangements interact with those in neighbouring markets? What is the impact of these interactions?

The GB charging arrangements and the charges derived from them along with those of adjacent member states will be important factors in determining flow patterns across the interconnectors. Although we expect other factors including contractual arrangements, gas quality and the prevailing supply / demand situation to also be influencing factors.

The analysis presented by Ofgem at the workshop on 8th July shows that IUK shows good price responsiveness but BBL less so. We consider this difference is likely to arise from the differing contractual arrangements and physical characteristics of the interconnectors. We understand that there have recently been changes to the market arrangements in The Netherlands and Belgium and consider these should be allowed time to become incorporated in trading strategies before consideration is given to change to the GB arrangements in advance of the implementation of the EU network code on tariff harmonisation. Cross border trade should also be enhanced when other EU network codes are implemented.

Energy UK is not unduly concerned about low utilisation levels of interconnectors when price differentials are small, since IUK acts as a marginal source of gas and has adequately demonstrated its ability to respond and flow at maximum import rates during the winter of 2013. We therefore do not consider security of supply to be at risk because of the charging arrangements.

Interactions with Ireland as well as continental Europe also need to be considered. Ireland is reliant on GB for supplies through Moffatt and security of supply could be affected by adverse changes to the charging arrangements.

Question 3: How do current arrangements give rise to these issues?

There is currently a surplus of entry capacity which means that capacity is readily available on a short-term basis. This short-term entry capacity is available at a substantial discount to the QSEC reserve price and has therefore given rise to a substantial under-recovery which is reflected in the TO entry commodity charge level.

TO exit commodity charges arise from capacity bookings not matching the baseline levels, in a similar manner to entry commodity charges these may become more significant in the future but equally booking patterns may evolve and substitution may well erode surplus baselines.

The TO entry or exit commodity charges feed into the marginal cost of flowing gas (but remains a small component of the total gas cost) whilst longer term capacity bookings may be regarded as sunk costs. However the impact of increasing short-term capacity costs and reducing commodity charges is difficult to assess from the perspective of impact on competition and customers tariffs. Energy UK considers that the impact of this needs to be very carefully assessed if the Framework Guidelines for the EU network code on tariff harmonisation is to be implemented at GB domestic points.

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?

GB would achieve compliance with the EU network code on tariff harmonisation without undertaking a wider ranging review of the charging arrangements that apply to GB domestic points. Minimal implementation is recommended by the HM Government Transposition Guidance: How to implement European Directives Effectively[1].

Whilst having two different charging regimes in GB, one applying to IPs and the other to GB domestic points may not seem like an ideal situation we consider it would be manageable and in any event the Framework Guidelines for the EU network code on tariff harmonisation requires that a single cost allocation methodology be used for all points which should help to mitigate any undue cross subsidies between transit and domestic flows.

The benefits of retaining the current charging regime at GB domestic points would help to support the well-functioning GB market and avoid the risk of unintended consequences that full alignment could lead to, which would seem to also require changes to all the capacity allocation mechanisms at entry and exit. The risks include:

- Deterring investment in supply / storage infrastructure if entry capacity cannot be secured at fixed costs;
- Volatility in capacity charges if booking levels vary year on year and there is no other means to ensure revenue recovery;
- The absence of a short haul tariff could promote bypass of the NTS; and
- Creation of new cross subsidies between peak and off-peak users, and competitive impacts of this.

Energy UK also notes that Ofgem recently approved different charging arrangements for Electricity IPs from those that apply to GB domestic generation / entry points.

Establishing our priorities for the review

Question 5: Are our goals for the review appropriate?

Ofgem identifies the objectives for the project to ensure that the structure of GB transmission charges protect the interests of future and existing consumers by:

● setting the right incentives for all parties

Energy UK is not entirely clear what this means, which parties do these incentives apply to and what are the 'right' incentives? We consider that the GB gas market is best served by a range of market participants with diverse business models. The charging methodology should not seek to unduly incentivise a particular type of behaviour. In our view this would be detrimental to competition.

●ensuring that GB transmission charges are compliant with emerging European network codes and Framework Guidelines

Yes, we agree compliance is mandatory. Further change to charges at domestic points is optional.

●ensuring that our approach to GB transmission charges at IPs and domestic points avoids any undue distortions.

Energy UK agrees that undue distortions should be avoided, but does not accept that this means that the EU network code on tariff harmonisation should apply to GB domestic points. Indeed we are

[1] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/229763/bis-13-775-transposition-guidance-how-to-implement-european-directives-effectively-revised.pdf

uncertain whether it would be possible to implement the EU tariff Network Code at domestic points without also aligning the entry and exit capacity products to which the tariffs apply.

Our Members hold a range of views, from an incremental approach should be adopted initially focussing on compliance at IPs with other important issues being addressed separately, to there should be a wide range review at this time. The incremental approach seems to be favoured by most of our members. However all agree that certainty is important, and any review will create a period of uncertainty which can have a damaging effect on investment and attracting new supplies to GB, especially in coming years as members seek to make investment decisions on new gas-fired generation plant.

Question 6: How could charging arrangements better meet the objectives set out in NGG' s special standard condition A5 which sets out the objectives for NGG"s charging methodology?

Energy UK Members will respond to this individually.

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?

The current charging objectives have served the industry well so does not think there is a need for change, although we consider that identifying a hierarchy in the objectives would be useful as it is not possible for the methodology to simultaneously meet all objectives if they have equal weighting.

Question 8: What other suggestions do you have for the objectives of our review?

None at this time, beyond ensuring that the GB market remains an attractive market for imports.

Question 9: What is your view on the timescale for our review?

Energy UK is unsure what timescale Ofgem is proposing; hence it is difficult to comment. We would however urge Ofgem to outline its expected timescale at the earliest opportunity.

We have concerns that the current Framework Guidelines for the EU network code on tariff harmonisation are not yet finalised and even when they are many of the details will be elaborated further in the associated EU network code on tariff harmonisation over the next 18 months. So whilst it is appropriate to begin thinking about the impact on GB domestic arrangements at IPs now, much of the detail will not be known for some time. We therefore query whether this is rather too early.

Our options

Question 10: Bearing in mind the issues and objectives you have identified, what options should be explored to address these?

Energy UK thinks it is premature to identify options at this stage rather further analysis and modelling of minimal implementation or rollout to all domestic points should be undertaken on

1) compliance with the principles of avoiding undue cross subsidies between domestic and transit flows and the cost allocation test
2) the magnitude of changes in charges at interconnection points
3) the impact of one regulatory pot

Question 11: What are the pros and cons of your suggested option?

The industry will have more information against which to make informed views on minimal implementation or a wider review.

In case of any query Julie Cox would be happy to discuss any of the points raised.

Note: This response represents a broad consensus of members' views, and we would point out that National Grid was not a contributor to this response.

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