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GAS TRANSMISSION CHARGING REVIEW – CALL FOR EVIDENCE

Dear Andy

We welcome the opportunity to respond to the 'Gas Transmission Charging Review – Call for Evidence' open letter. This response is provided on behalf of National Grid, as National Grid Gas plc (NGG) in its role as owner and operator of the Gas Transmission System in Great Britain.

A full response to the questions raised in the open letter is provided in Annex 1.

We believe that a review of the charging arrangements is timely considering the development and implementation of the European network codes, the current quantities of allowed revenues recovered from commodity charges and the impact this is having on the energy industry and consumers.

We agree with the main objectives of the review as outlined in the open letter. In addition we believe that the review should consider:

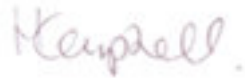
- whether the current level of discount provided for short term capacity products is appropriate;
- whether the current regime provides robust and timely transmission system investment signals; and
- whether the current charging regime is fit for purpose when considering the forecast change in transmission system utilisation, demand and supply levels, profiles and patterns.

We believe that encouraging long term bookings will improve investment signals and also the predictability of Transmission charges. This could, in part, be achieved by decreasing the incentives to buy short term discounted capacity products. The current level of obligated capacity, the corresponding quantities of long term gas capacity purchased and the level of discounted capacity sold does not always provide robust and timely investment signals.

We welcome the opportunity to work with Ofgem and the industry to consider the impacts of minimal implementation of the proposed European network codes that focuses changes on interconnector points only. We believe that any such proposals (e.g. removal of commodity charges from interconnector points) will need careful consideration.

If you wish to discuss any of these issues or comments further, or have any other queries regarding this response, please contact Malcolm Arthur at malcolm.arthur@nationalgrid.com (01926 654909).

Yours sincerely

A handwritten signature in purple ink that reads "H Campbell".

Helen Campbell
Head of Commercial Frameworks - Gas

cc Alex Whitmarsh - Ofgem

Annex 1 – National Grid Gas Transmission Detailed Responses to Questions raised in Call for Evidence

Question 1: What has given rise to the current balance between charges for access to the transmission network? How might this change in future?

In order to collect the Allowed Revenues on both Transmission Owner (TO) and System Operator (SO), National Grid Gas (NGG) levies charges on transmission system users outlined in Table 1.1 below:

Table 1.1 – Principal charges used to collect Allowed Revenues

Allowed Revenue	Principal charges used to collect Allowed Revenues ¹
TO Allowed Revenue	NTS TO Entry Capacity charge NTS TO Entry Commodity charge NTS TO Exit Capacity charge NTS TO Exit Commodity charge
SO Allowed Revenue	NTS SO Entry Commodity charge NTS SO Exit Commodity Charge

National Grid sets charges so that 50% of Allowed Revenues are recovered from users entering gas onto the transmission system (Entry charges) and 50% of Allowed Revenues from users exiting gas from the transmission system (Exit charges). This applies to both the TO and SO Allowed Revenues².

NTS Entry Reserve prices are calculated to reflect the Long Run Marginal Cost (LRMC) of providing capacity at different entry points on the National Transmission System (NTS). Users looking to enter gas onto the transmission system buy capacity. This capacity has a predetermined price (Reserve Price); these prices are not adjusted to ensure that Allowed Revenues are fully collected. The revenue from NTS Entry Capacity sales count towards the 50% target TO Allowed Revenue required to be recovered from TO Entry Capacity charges. Any excess or shortfall is redistributed or collected via the TO Entry Commodity charge. This Entry Commodity charge is currently smeared across all system entry users dependent on their throughput.

NTS Exit Capacity charges are initially calculated to reflect the Long Run Marginal Cost (LRMC) of providing Exit Capacity at different exit points on the NTS. However, NTS Exit Capacity charges have an additional revenue based element that aims to adjust Exit Capacity charges such that they recover the target 50% of TO Allowed Revenue from the total NTS Exit Capacity charges. Up until October 2012 TO Exit Revenues were wholly recovered via NTS Exit Capacity charges. From October 2012 a TO Exit Commodity charge was introduced to recover any anticipated shortfall or redistribute any excess of the target 50% TO Allowed Revenue from NTS Exit Capacity charges³. This TO Exit Commodity charge is currently smeared across all system exit users dependent on their throughput.

Whilst both the TO Entry and Exit Commodity charges are levied based on throughput, gas entering and leaving Storage does not attract Commodity charges. This is due to the same gas having

¹ In relation to SO Allowed Revenues, additional charges levied by National Grid include the St. Fergus Compression charge and the optional NTS Commodity tariff ("Short Haul").

² The 50% split is taken after the appropriate targeted charges and applicable revenues are taken off the target revenue to collect from TO and SO charges.

³ A shortfall or excess may occur due for two main reasons. Firstly the need to recover the TO allowed revenue within the formula year and the misalignment of the charge setting year for NTS Exit Capacity charges (1st October – 30th September) and the formula year (1st April - 31st March). Secondly, a short-fall in exit capacity revenues against target could be as a result of a short-fall in exit capacity bookings, recognising that charges are set so as to recover target revenues from baseline levels of capacity.

attracted the Commodity charges when entering and exiting the NTS and therefore no charge is made at Storage facilities to prevent double counting.

National Grid has seen a continued reduction in the proportion of revenue collected from TO Capacity charges via the entry auctions and exit applications/auctions, although to date this has been more noticeable on Entry than Exit. This has given rise to an increase in the amount (as a proportion of target revenue in the respective formula years) required to be collected through TO Commodity charges. Whilst only introduced in 2012, there is the potential that the trend seen so far in increasing TO Exit Commodity charges continues and therefore could ultimately result in a TO Exit commodity charge that would be required to recover more revenue due to lower Exit Capacity revenues. Chart 1 below shows the trend in booking Off Peak⁴ Exit Capacity from October 2012 to August 2013 and there is a general increase from October to August in the level of Off Peak allocated. Should this trend continue then it is likely that the proportions of revenue required to be recovered from the TO Exit Commodity charge will increase.

Chart 1: Trend in the average off peak capacity allocated from October 2012 to August 2013

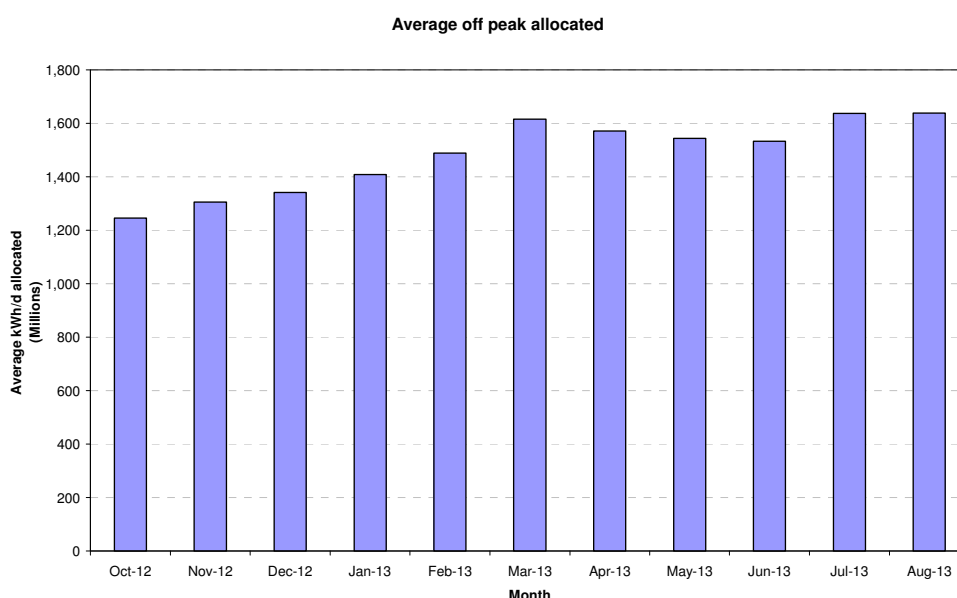


Chart 2 below shows the reducing trend of the proportion of revenues obtained from the Monthly System Entry Capacity (MSEC) Auctions. In addition the revenues from longer term bookings through the Quarterly System Entry Capacity (QSEC) has remained relatively constant. Although the combined revenue from these two elements has remained relatively stable since 2009 the Allowed Revenues have increased⁵ over the same period resulting in a reduced proportion of the Allowed Revenue being met by auction revenues. Therefore the TO Entry Commodity charge has increased over time to recover the Allowed Revenues. The TO Entry Commodity charge is also quite volatile and sometimes varies within year as detailed in Chart 5. This trend can be attributed, in part, to the difficulty in predicting behaviour in booking capacity in the short term, especially where there continues to be a shift to purchase entry capacity in auctions where the reserve price is discounted by 100% (zero reserve price).

Table 2 shows the percentages of Allowed Revenue recovered from TO Entry Capacity Sales and from TO Entry Commodity charges. This shows an increasing trend in the percentage of Allowed

⁴ Off-peak NTS Exit capacity is auctioned on a daily day ahead basis with a zero reserve price and can be scaled back by National Grid at any time.

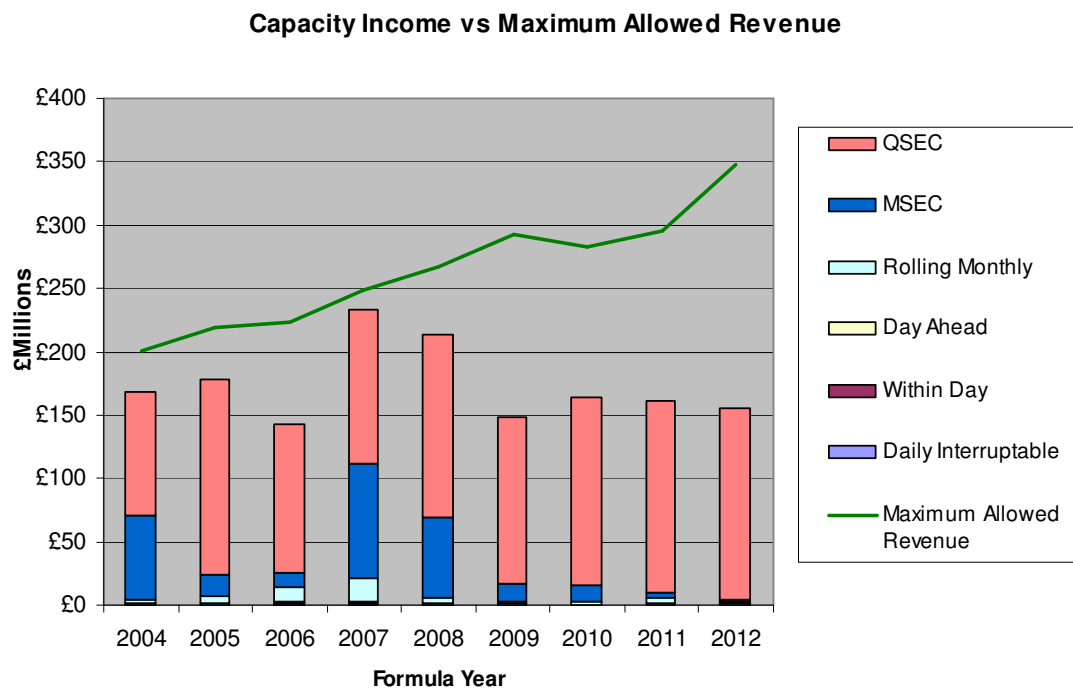
⁵ Allowed revenues have increased to reflect increased levels of investment in the NTS.

Revenue required to be recovered from TO Entry Commodity charges rising from 17% in 2004 to 55% in 2012.

Table 2: Percentage of NTS TO Entry revenue by Formula Year recovered from Capacity and Commodity

	Formula Year									
	2004	2005	2006	2007	2008	2009	2010	2011	2012	
% Revenue from NTS TO Entry Capacity Sales	83%	82%	64%	93%	80%	51%	58%	55%	45%	
% Revenue from NTS TO Entry Commodity Charges	17%	18%	36%	7%	20%	49%	42%	45%	55%	

Chart 2: Trend in the capacity sales in relation to TO Allowed Revenue for Entry



The revenues and quantities booked relating to particular formula years through QSEC and MSEC auctions alongside the values from discounted capacity products can be seen in Charts 3 and 4 below. Over the period from 2004 to 2012 there has been a rise in the QSEC capacity bookings by volume but a relatively steady amount of revenue. For the same period there has been a reduction in the volume of capacity allocated for each year and for revenues associated to MSEC auctions. Discounted products has seen a general increase in the volumes of capacity allocated and, given that they are discounted, a consistent low revenue stream.

Chart 3: Volumes of Capacity Sales for Capacity booked relating to Formula Years

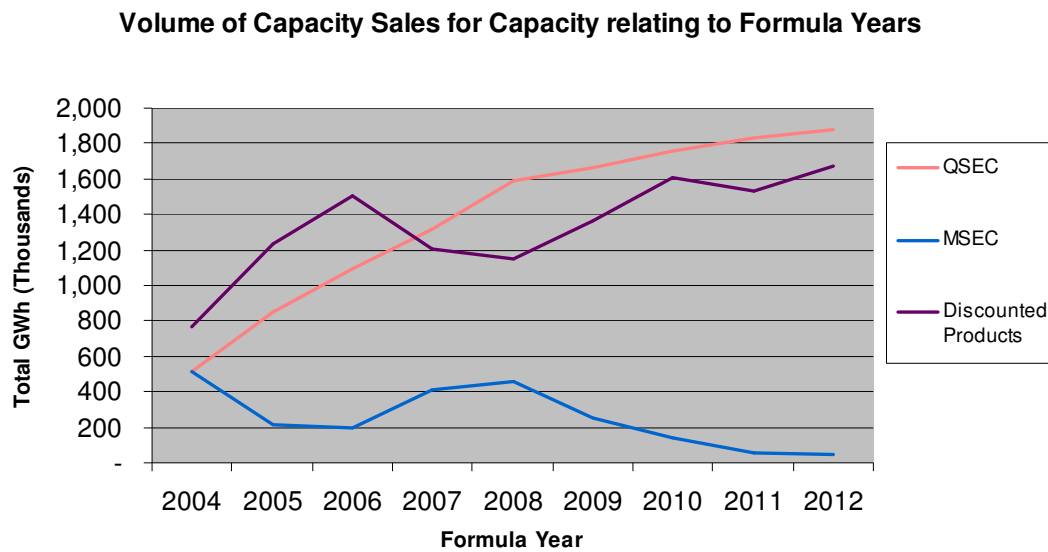
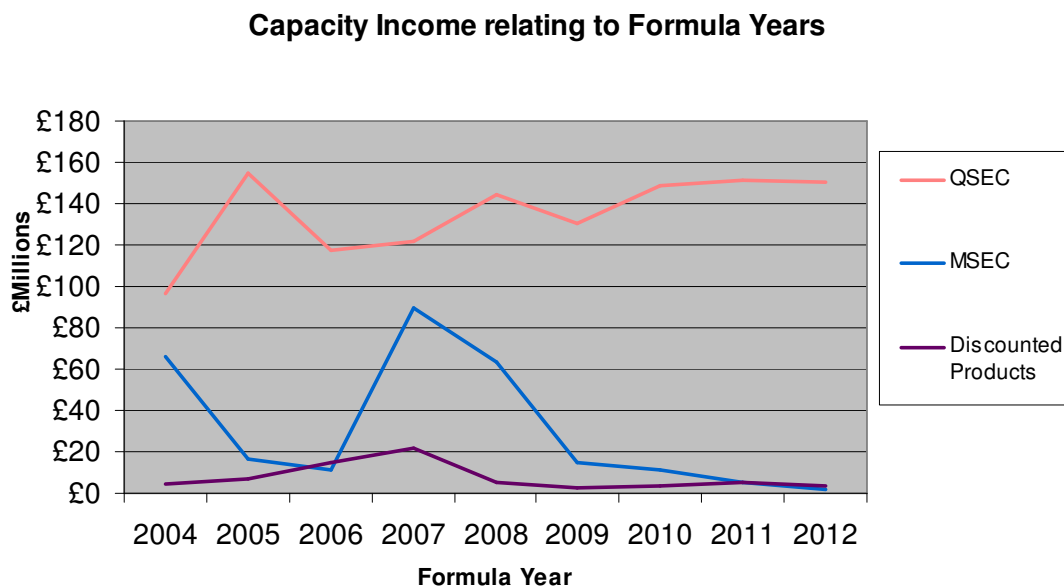


Chart 4: Revenues received from Capacity sales by Formula Year

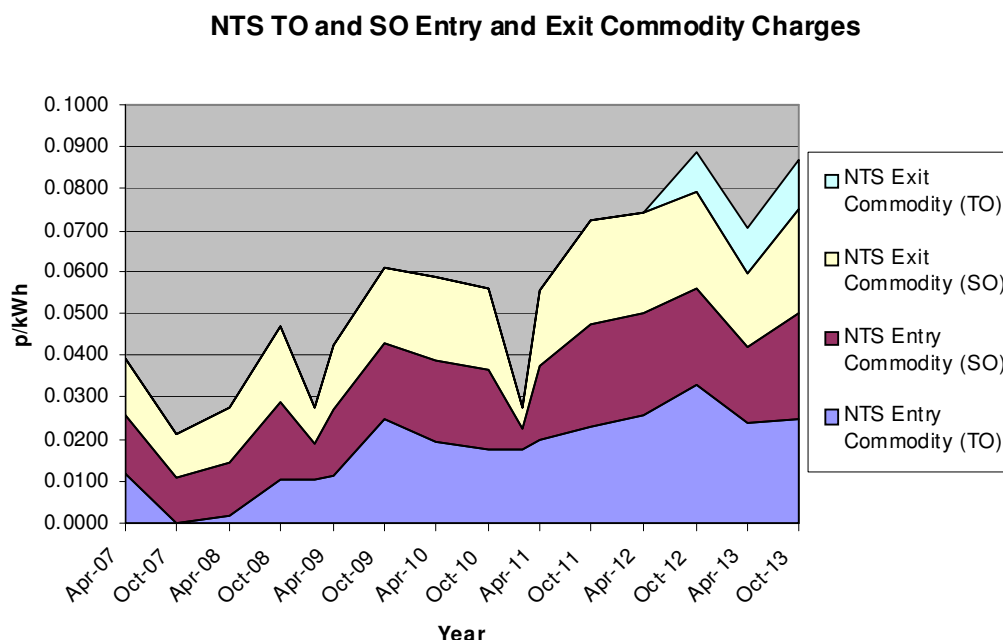


There has been a general increase in capacity volumes allocated but relatively constant revenues generated from QSEC auctions. This, coupled with a continuing trend in the procurement of short term capacity (i.e. day ahead and on the day) where there has historically been little risk of the required capacity not being available increases the proportion of Allowed Revenue required to be recovered from the TO Entry Commodity charge is increasing. It is our view that the larger quantities being booked in the within day auctions is driven by the zero reserve price and large quantities of Entry capacity being made available.

Chart 5 below shows the overall trend in the Commodity charges (both TO and SO). Looking at the TO commodity charges these have shown an overall upward trend over time and can be volatile. Over

time the levels of Commodity charging have risen, particularly on TO Entry charges because they have been set to recover more revenue as a proportion of target revenues than the TO Commodity charge was originally envisaged to recover.

Chart 5: Trend in the individual and overall Commodity charges



There has been an increase over recent years in the amount of capacity booked through discounted capacity products on Entry, notably through the allocation of increased volumes of capacity at the zero reserve auction price on Entry (both firm within day and interruptible day ahead) and via Off-Peak Exit Capacity. When Users choose to book this capacity via these auctions rather than those auctions/applications with reserve prices greater than zero this reduces the revenue generated via the auctions/applications.

The increased likelihood of short term capacity being available at discounted prices (often at 100% discount) decreases the incentive to book long term capacity due to the historic low level of risk in capacity being unavailable or in the case of Interruptible/Off-Peak being removed from the Users who have booked such capacity.

Implementation of the new RIIO-T1 price control on 1 April 2013 introduces additional uncertainty into the Allowed Revenues which are ultimately used in the calculation of charges. Customers have highlighted their concerns⁶ with charging unpredictability and volatility.

There are a number of drivers that we believe will increase the amount of Allowed Revenue recovered through commodity charges: These are:

- forecast decrease in future gas demand
- corresponding reduction in supply (to match demand)
- availability of capacity in the short term will therefore increase (with a discounted Reserve Price)
- increase in off-peak capacity

⁶ Minutes from NTSCMF on 20th July 2012 - <http://www.gasgovernance.co.uk/ntscmf/200712>

- a higher risk of parties moving towards discounted short term capacity products

In summary, we believe that there is a high risk that, with the current regime of discounted short term products, and expected levels of future capacity requirements, the level of Allowed Revenue collected from system users via Commodity charges will increase. It is our view that the larger quantities being booked in the within day auctions is driven by the zero reserve price, large quantities of Entry Capacity being made available in this auction, the low risk of capacity not being available and, at some Entry Points, a lack of competition for the available Capacity. These elements also contribute to charging unpredictability and volatility. We also believe that this is also driven by Allowed Revenue uncertainties and this should be discussed within this charging review and we welcome the opportunity to work with Ofgem and the industry on how to better meet customers' requirements whilst maintaining the collection of Allowed Revenues.

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?**

There are a number of issues which we discuss below, however one of the key issues is the lack of robust and timely investment signals and the impact this has on planning network investment. In our view this is largely driven by the high level of discounted capacity available and booked as an alternative to longer term capacity with reserve prices above zero.

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

Efficient investment is best based on long term signals. However, current charging arrangements incentivise short term procurement of capacity through zero reserve prices. The ability to reduce costs by profiling capacity booking by using shorter term products which are flat priced throughout the year also undermines long term signals.

Is capacity available when needed?

The use-it-or-lose it arrangements ensure that short-term Off-Peak / Interruptible capacity is available when needed and National Grid has obligations to release firm capacity (Entry and Exit) day ahead and within day (with within day for Entry Capacity at zero reserve price). The attractiveness of these zero-priced products means that longer term capacity may not be procured and this may lead to investment signals not being received and hence may mean that there is a risk of capacity not being available in the longer term or in the right location.

Do charging arrangements help NGG to plan network investment?

The capacity arrangements generally help NGG to plan network investment; however, the charging arrangements create an incentive to defer capacity procurement to beyond the point when they can be taken into account when making network investment decisions and hence there is a risk that an investment signal is received too late to make the capacity available.

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

Commodity rates are generally lower in neighbouring markets and therefore the short term marginal cost of trading, for parties holding capacity for durations longer than a day, is lower in those markets than GB. The asymmetrical entry/exit commodity charges at interconnection points may have an impact on trading.

Charging arrangements are not directly coordinated with neighbouring markets; improved coordination would be beneficial in promoting cross border trading.

In addition to these issues Industry stakeholders have previously raised the issue of price predictability and volatility to National Grid. These were also raised as part of Ofgem's Network Charging Volatility Consultation⁷. In response to industry concerns on volatility National Grid continues to work with Ofgem and industry to keep the charging arrangements under review to help address charging issues such as volatility⁸ and predictability through the NTS Charging Methodology Forum.

The issues that contribute to the volatility, unpredictability and high levels (in the case of TO Commodity) of charges are:

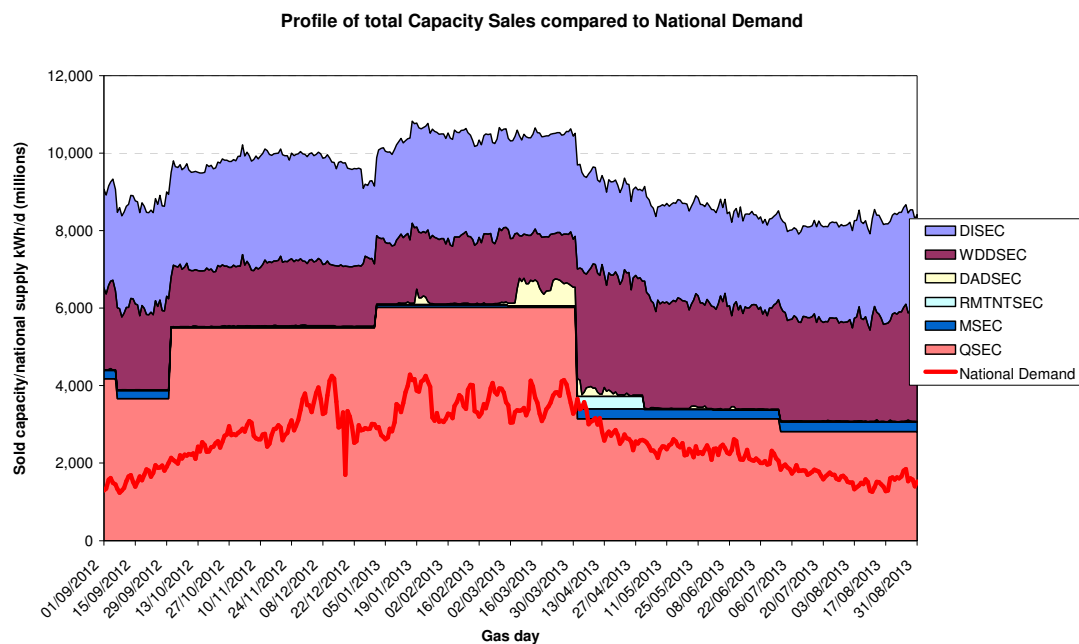
- Where the Allowed Revenues are greater than the revenues generated from capacity sales the shortfall is met via TO commodity charges. As the Allowed Revenues are increasing and the revenues from capacity sales have been relatively static in recent years this has resulted in a higher proportion of the revenues being generated from TO commodity charges. Having revenue adjusted charges on Exit helps reduce the amount required to be recovered from TO Exit Commodity Charges as the NTS Exit Capacity Charges are set the year before use and as such utilise more up to date information and are adjusted to meet the Allowed Revenues. Whereas on Entry, without corresponding revenue adjustments, coupled with the levels of long term bookings this has contributed to a shortfall in capacity revenues and as such higher TO Commodity Charges.
- Discounts on Capacity. We consider that the current charging regime does not incentivise parties to buy the capacity they need when they know they need it. Instead it encourages parties to wait for the availability of discounted short term products rather than buy longer term capacity. With the availability of the discounted short term products being high, there is limited risk of capacity not being available. As the balance between long and short term capacity booking continues to move towards short term products this results is likely to continue to impact long term poor investment signals.
- A lack of scarcity of capacity. Capacity is generally available when needed and is often booked at greater volumes, in aggregate, than the NTS capability, although we recognise that Users do not necessarily flow into that capacity. This does not contribute to efficient investment planning as long term capacity bookings do not reflect the levels that are actually needed by Shippers and as such are not potentially providing the signals through the auctions / applications that would otherwise be given if capacity bookings were made earlier and for the amounts needed. The regime does provide flexibility to Shippers but bookings in the zero reserve price within day auction generate minimal, if any, revenues from the capacity sale. Chart 6 below shows the total TO Entry Capacity sales from September 2012 to August 2013. Comparing the overall capacity sales compared to the national demand we believe that there are some key conclusions that can be drawn:

⁷ <https://www.ofgem.gov.uk/publications-and-updates/mitigating-network-charging-volatility-arising-price-control-settlement>

⁸ In January 2013 a one off change to NTS Exit Capacity charges was implemented following Ofgem and Industry consultation in an effort to reduce the magnitude of changes to NTS Exit Capacity charges in the short term. NTSGCD10 Potential one-off change to TO NTS Exit (Flat) Capacity Charges for April 2013
(<http://www.nationalgrid.com/uk/Gas/Charges/consultations/Current+Discussion+Papers/>)

- Capacity sold far exceeds demand (with capacity sold averaging over the period September 2012 to August 2013 between three and four times higher than National demand) ; and
- Capacity is either sold long term (QSEC) or short term (day ahead or within day), approximately 60% Long and 40% short; and
- Where there is scarcity of capacity this does encourage competition for capacity. In part of March 2013 there was competition for capacity when demand increased and capacity was sold via day ahead auctions.

Chart 6: Comparing the total of Capacity Sales by product against National Grid Demand



- Allowed Revenues and uncertainty – Under RIIO-T1 there is additional uncertainty (when compared to the previous regime) in our Allowed Revenues that will be used in the calculation of charges to recover such Allowed Revenues. How this impacts customers will need further consideration. Allowed Revenues used in charge setting have a strong linkage to timings of any adjustments and outputs which influence revenues over the RIIO-T1 period.
- Investment signals – It is National Grid’s view that the NTS capacity prices also provide information to users on where to connect within the network/provide signals for additional capacity and that this has historically been a key element of the existing regime.

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

Given the amount of capacity available at discounted rates this reduces the risk of short term capacity not being available and as such does not appropriately incentivise medium/long term bookings. The reduced proportion of revenue recovery from long term auctions puts upward pressure on commodity charging. Having TO Commodity charges recover large amounts of anticipated under recovered Allowed Revenue results in a greater proportion of charges being recovered from those who have previously booked long term capacity than from those acquiring capacity short term at discounted rates. This therefore provides a further disincentive to book long term. This also brings with it charging

uncertainty and volatility depending on the behaviour in booking capacity. This could be reduced were there to be more capacity booked in the longer term therefore providing greater certainty in the revenues generated from capacity sales or there was a decrease in the level of discount applied to the short term capacity products that better reflected the requirement of capacity bought to recover Allowed Revenues and the risk of these products not being available.

Other arrangements that contribute to, or are impacted by, the issues mentioned are:

- A lack of scarcity of capacity – Large volumes of capacity are made available at a discounted price⁹ in the short term with a historically low risk of capacity being unavailable which in turn results in lower proportions of Allowed Revenues being collected from capacity charges and increases the respective TO Commodity charge. This results in parties booking long term capacity picking up additional costs due to those who “wait and see” and benefit from discounted short term products.
- Whilst there is a difference between the calculation of NTS Exit Capacity charges and NTS Entry Capacity charges in that Annual Exit Capacity charges are adjusted for Allowed Revenues and Entry charges are not. Consideration must be given to any Entry Capacity price changes and the impact that they may have on the certainty/volatility of long term pay as bid prices as this could provide additional disincentives to long term bookings.
- Lack of competition for capacity – At some system entry and exit points there is little competition for capacity contributing to a lower risk of capacity being unavailable and therefore raising the commodity charges as a result of large capacity amounts being booked at discounted levels.
- Interactivity with Electricity – Power stations moving away from firm NTS Exit Capacity relying on off peak capacity could impact the availability of such plant, if there were a constraint on the NTS.
- Relating to charging arrangements helping NGG plan for investment – The capacity arrangements generally help NGG to plan network investment; however, the charging arrangements create an incentive in some cases to defer capacity procurement to beyond the point when they can be taken into account when making network investment decisions and hence there is a risk that an investment decision is received too late.
- Allowed Revenues and uncertainty – Under RII0-T1 there is additional uncertainty in the Allowed Revenues that are used in the calculation of charges. The ability to provide meaningful and timely forecasts of the Allowed Revenues to be used in determining charges would help in improving the predictability, although not necessarily the volatility, of charges. Knowing Allowed Revenues to be used for particular years as far in advance as practicable would assist in providing useful forecasts for charging purposes, particularly with regards to NTS Exit Capacity charges, to help Customers in their planning for future years.
- Neighbouring markets – Consideration needs to be given in terms of what this review may do, how neighbouring markets charge and how they may be implementing potential change to ensure that no adverse affects on flows would result across IPs. More information on the impact of the Framework Guidelines and EU Codes being considered is outlined in our response to Question 4.

⁹ This includes Firm Entry Capacity Day ahead and within day, interruptible NTS Entry Capacity (released day ahead) and Off-Peak NTS Exit Capacity (also released day ahead)

Question 4: In the event that there were to be minimal implementation of the Framework Guidelines/network codes as currently drafted, e.g. no subsequent changes at domestic points, what would be the impact?

Until the Framework Guidelines and EU network codes are finalised there is little certainty in predicting what changes will be required. However, with minimal implementation of the currently proposed Framework Guidelines¹⁰, the impacts could result in:

- Potential disproportionate allocation of transmission costs between domestic and interconnection points which may result in some costs that should be apportioned to interconnector points, being picked up by domestic points (and vice versa).
- A more complex charging regime.
- Potential disparity between domestic entry / exit charges at Bacton and interconnector entry / exit charges at Bacton.

In the event of minimal implementation of the EU Framework Guidelines as currently drafted with only changes at Interconnection Points (IPs) then it is National Grid's initial view that the following changes would be required at IPs:

- Removal of commodity charges at interconnector Entry and Exit Points except for 'variable costs' such as fuel costs.
- For IPs an adjustment to the reference/reserve price is envisaged by the draft Framework Guidelines relevant to all points which would mean Entry Capacity reserve prices for the annual product (at IPs) would probably need to be adjusted (or 'rescaled') to match Allowed Revenues for interconnector points. This would be a change from what is currently in place that would probably require a move from a pay-as-bid approach to charges being confirmed shortly before the capacity is utilised. Having revenue adjusted charges amended for Allowed Revenues for Exit Capacity is the existing charging methodology arrangements in place across GB.
- The relative reserve pricing (i.e. use of multipliers) for short term products at IPs would need to be reconsidered to ensure that domestic points are not incurring additional charges as a result of any revenues not recovered from charges levied on IPs.
- Interruptible capacity at IPs, where released, according to the rules in the Capacity Allocation Mechanisms (CAM) code, will be subject to reserve prices that reflect the likelihood of interruption. 'Back-haul' charges at IPs (that is interruptible commercial reverse flows) will need to be priced at 'the cost the TSO incurs to provide this service'.

As a result of these potential changes these will require changes to the charging methodology and the use of the regulatory account for under/over recovery would need careful consideration.

¹⁰ http://www.acer.europa.eu/Official_documents/Public_consultations/Pages/PC_2013_G_03.aspx

Question 5: Are our goals for the review appropriate?

National Grid agrees with the objectives for the review to achieve the most appropriate structure of GB Transmission charges for future and existing consumers. In addition, we believe that any change in arrangements should aim to deliver a regime which is fit for purpose for the next 10 – 20 years. National Grid believes that the goals should include a review of the charging arrangements to determine if the forecast change in transmission system utilisation, demand and supply levels, profiles and patterns and trends in booking capacity warrant changes to the charging regime.

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?

National Grid believes the current charging arrangements meet the objectives set out in Special Standard Condition A5 of the Gas Transporter Licence in respect of the NTS (the Licence). To better facilitate the relevant objectives the charging arrangements could better meet these objectives through further consideration of:

- Improved cost reflectivity of reserve price levels and the relevance of the cost reflectivity of charges if auction reserve prices are not cost reflective.
- Potential refinements to the application of, and level of, discounts applied when pricing, short term capacity products.
- Review the level of capacity available at discounted levels to encourage more long term booking and competition. This could increase competition for capacity and encouraging longer term booking, thereby increasing the revenues from capacity sales and lowering commodity charges.
- The use of capacity charges as a means to provide investment information/signals and whether the existing framework best encourages this.
- Reviewing the application of Commodity charges that could include more targeted charging. Such changes could consider targeting commodity charging at Shippers based on when and how capacity was bought, for example, introduce higher commodity charges for those benefitting from shorter term discounted products and a review of discounts and eligibility for them.
- Consider reviewing the application of the Short Haul (NTS Optional Commodity) Tariff.

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?

National Grid believes that the objectives set out in Special Standard Condition A5 of the Licence are fit for purpose in providing appropriate rules to govern how charges should be set and the principles underpinning their calculation. However, they would benefit from a review in order to ensure that, where discounts are applied to capacity products, the resulting charges meet the relevant objectives. Any changes to the charging regime resulting from Ofgem's review should, where possible, consider the following so that the changes:

- Recover NGG's Allowed Revenues
- Be cost reflective
- Improve cost allocation
- Avoid undue discrimination

- Comply with EU Regulations and Codes
- Take account of developments in the transportation business
- Be predictable and transparent

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

In addition to those given we would encourage:

- o Improved cost allocation of Allowed Revenues on those that utilise the system; and
- o To address the balance of charges being recovered through commodity charges by resolving some of the issues causing lower revenues from capacity bookings. As detailed in earlier responses we would encourage Ofgem and the Industry to look at the appropriateness of the capacity discounts and zero reserve prices.

In National Grid's opinion it would be beneficial to encourage more longer/medium term capacity bookings reflecting the individual Shipper's capacity requirements whilst recognising that these will change over time. A key element of encouraging such bookings would be a review of the drivers behind the current trend towards short term bookings.

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

National Grid believes that it is appropriate to consider the impact of potential EU framework guidelines as early as possible and therefore think it is beneficial for Ofgem to consider the implications on GB at this stage. However it should be recognised that the EU Framework Guidelines are not currently finalised and as such are subject to change and will need to be reviewed throughout the development of the EU codes.

The outcome of the Framework Guidelines (once finalised) will need to be reviewed to ensure that there is adequate understanding of the impacts and full assessment of the consequences of:

- a. Applying the EU Framework Guidelines at IPs only; and
- b. Applying beyond solely IPs to the rest of the GB Domestic NTS Entry and NTS Exit Points.

A review of the impacts of the EU code at the earliest opportunity would allow time to consider and consult on potential options of any alternatives with Industry Stakeholders and provide time to implement.

The timescales for this review should not jeopardise EU Code implementation and until EU Codes are agreed we will not know what the full extent of the impacts on GB, specifically the charging regime.

Any implementation timescales should also recognise that there are likely to be IS System implications on Xoserve managed systems, Customers and National Grid.

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

One of the key triggers for this review was the increased concern regarding high, unpredictable and volatile TO Commodity charges and these need to be considered as part of any solution.

Options that should be explored further include the following or a potential combination of:

- 1) Reviewing the discounts applied to capacity products to encourage more long term booking and competition (e.g. the zero reserve price on a) within day firm Entry and b) interruptible for entry/off peak for Exit).
- 2) Review the level of capacity available at discounted levels to encourage more long term booking and competition. This could be addressed through discounted products that would only become available once a defined level of firm capacity has been sold or a discount on short term products that better reflects the likelihood of them not being available (e.g. user pay 90% cost of firm for a product that is available 90% of the time. This could help encourage competition before discounts are available therefore increasing the certainty of revenues from capacity auctions).
- 3) Revenue adjusted charges on TO Entry Capacity reserve prices. This would be a similar approach to that on TO Exit Capacity in that it would apply an adjustment to recover Allowed Revenues from capacity sales and aim to minimise any recovery from TO Entry Commodity.
- 4) The application of targeted TO Commodity charging (e.g. based on the timings of when capacity bookings are made). For example, bookings made in the longer term could qualify for a lower TO Commodity charge than those booking in the short term, introducing an increased incentive on booking longer term. Another example could be the earlier adoption of the removal of Commodity from IPs, as outlined in the draft Tariff Framework Guidelines on EU codes to improve coordination with neighbouring markets within the EU.

Whilst some of these suggestions have previously been explored with the industry at various NTS Charging Methodology Forum (NTSCMF) meetings and via charging methodology consultation papers, such as the removal of the zero reserve price under NTS GCM 19: Removal of Daily NTS Entry Capacity Reserve Price Discounts¹¹, National Grid believes it is worth revisiting the items that NTS GCM 19 looked to address. In conjunction with some of the other recommendations for change to be considered here, we believe that the objectives of promoting competition, improving cost reflectivity and improving cost allocation can be achieved with a review of the discounts, specifically the removal of, or limiting, zero reserve prices and when they are utilised.

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

Of the options considered in our response to Question 10, there are likely to be winners and losers as changing how monies are recovered will impact the charges of Shippers. However this is balanced against the improved allocation of Allowed Revenues in the charging regime. Any potential option also needs to assess the implementation / cost elements i.e. changes to processes and IS systems. In the table below we outline the pros and cons of these options:

¹¹ http://www.nationalgrid.com/uk/Gas/Charges/consultations/archive_consultation_papers/

Option	Pros	Cons
<p>1</p> <p>Review the level and application of discounts on capacity bookings (such as the removal of 100% discounts)</p>	<ul style="list-style-type: none"> ▪ If reviewed with the availability of capacity (option 2), this option should encourage longer term bookings and reduce short term bookings. This would increase revenues from capacity sales and lower the proportion of target revenues required to be recovered through commodity charges. ▪ Incentivises long term booking providing better operational planning information to National Grid and leading to more efficient investment. ▪ Addresses cost allocation issues between long and short term capacity holders therefore benefitting competition between Shippers. ▪ Potentially provides greater predictability in Commodity charges where increased long term bookings are made contributing towards reducing volatility in charges to Customers. ▪ If there is less access to short term capacity then this should improve competition for longer term capacity at levels higher than a zero price generating revenues and reducing the level of commodity charges. 	<ul style="list-style-type: none"> ▪ Without a review of the amount of capacity qualifying for discounts this option may have a limited impact. ▪ If there is less access to short term capacity then this could impact security of supply as gas may flow elsewhere (not GB) or where power stations are relying on off peak capacity instead of firm bookings.
<p>2</p> <p>Review the level of capacity available at discounted levels</p>	<ul style="list-style-type: none"> ▪ Increase competition for capacity by potentially reducing the amount available as discounted coupled with a significant proportion being required to be booked before discounted products become available. ▪ Incentivises long term booking, this should improve investment decisions and provide more appropriate signals as a means of assessing needs for additional investment. ▪ Encourages longer term booking from short term reliance then would increase revenues from capacity sales and lower the proportion of target revenues required to be recovered through commodity charges ▪ Potentially greater predictability in Commodity charges where increased long term bookings are made 	<ul style="list-style-type: none"> ▪ Depending on the level of capacity available at discounted rates at Entry points with little or no competition this may not reduce commodity charges if there is a continued use of discounted capacity. ▪ If the level was set too high before discounted capacity could be booked and there were lower levels of capacity booked in the Long term this could impact Security of Supply. ▪ If there is less access to short term capacity then this could impact security of supply as gas may flow elsewhere (not GB).

Option	Pros	Cons
<p>3</p> <p>Revenue adjusted charges for TO Entry Capacity</p>	<ul style="list-style-type: none"> ▪ Based on the current Framework Guidelines – this would be consistent with the proposed European Framework Guidelines ▪ With appropriate incentives on encouraging long term booking perhaps addressing the lack of competition at some entry points then this could raise the revenues from TO Entry Capacity sales. This option also provides less of a trade off between long and short term as if Users book short term revenues are still generated, therefore providing greater certainty of charges. 	<ul style="list-style-type: none"> ▪ Would introduce uncertainty to the prices actually paid as this would not be known before capacity is used and could lower the incentive to book long term without knowledge of the price to be paid (that is currently in place). ▪ Would need to consider predictability and stability in addition to this to incentivise long term bookings ▪ If less access to discounted capacity then this could impact security of supply as gas may flow elsewhere (not GB).
<p>4</p> <p>Targeted TO Commodity Charges (for example, higher commodity on short term bookings that have taken capacity at discounted levels)</p>	<ul style="list-style-type: none"> ▪ Improves cost allocation and provides an increased incentive to book long term by providing a higher level of uncertainty for those purchasing short term discounted products. ▪ Through encouraging longer term booking this should promote more charging stability and predictability if the levels required from Commodity are reduced. 	<ul style="list-style-type: none"> ▪ Targeted commodity charges on those purchasing short term products could act as a barrier to entry for market competition ▪ Complexity to the charging regime