

Modification proposal:	Uniform Network Code (UNC) 517, 517A and 517B: Review of the Supply Matching Merit Order in Setting Capacity Charges; A –with Timing of Resultant Price Changes; B – with Rolling Average to Reduce Volatility (UNC517/A/B)		
Decision:	The Authority ¹ has decided to reject these modification proposals ²		
Target audience:	UNC Panel, Parties to the UNC and other interested parties		
Date of publication:	25 September 2015	Implementation date:	n/a

Background

National Grid Gas Transmission (NGGT) uses the transportation model (TM) to calculate entry and exit capacity charges under the charging methodology in section Y of the UNC. In order to generate the capacity charges, a number of supply and demand assumptions are built into the TM. Supply must equal demand for the TM to be able to generate capacity charges. To achieve this, the TM assumes a specific order in which different types of supply sources flow to meet demand – this is known as the merit order.

The current merit order is shown below. The amount of gas supplied from each of these sources is reduced to zero in this order until a balance is reached with demand:

- i. Short range storage facilities
- ii. Mid-range storage (MRS) facilities
- iii. Liquefied Natural Gas (LNG) importation facilities
- iv. Long range storage facilities
- v. Pipeline interconnectors
- vi. Beach terminals

The current merit order was implemented in 2009. NGGT is required to keep it, as part of the wider charging methodology, under review as part of its Licence conditions.

The modification proposals

NGGT proposed UNC517 to change the merit order. Specifically, to combine MRS facilities and LNG importation facilities into a single group which would be pro-rated to meet demand.³ NGGT's view is that the information they provided in Table One below suggests there has been a change in the utilisation of gas supplies from MRS and LNG facilities over the past five years.⁴ They consider that this justifies combining LNG and MRS into a single group as both have been used as a supply source on highest demand day in each year.

¹ References to the "Authority", "Ofgem", "we" and "our" are used interchangeably in this document. The Authority refers to GEMA, the Gas and Electricity Markets Authority. The Office of Gas and Electricity Markets (Ofgem) supports GEMA in its day to day work. This decision is made by or on behalf of GEMA.

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

³ This means an equal percentage of gas from mid-range storage facilities and LNG importation facilities will be used to achieve a demand balance, if required.

⁴ This table is taken from the Final Modification Report (FMR).

Table One: Supply utilisation from LNG and MRS sites on the highest demand day:⁵

Year	LNG	MRS
2010-11	17.36%	3.77%
2011-12	18.70%	12.12%
2012-13	7.70%	16.79%
2013-14	2.47%	13.24%
2014-15	10.71%	6.61%

UNC517A proposed by Wales and West Utilities (WWU) and UNC517B, proposed by Scottish and Southern Energy (SSE) aim to reduce charging volatility which both proposers consider will occur if UNC517 is approved.

UNC517A proposes to implement the revised merit order from a “future date” around three years after any decision to approve the modification is made.⁶ WWU consider this is necessary to allow them to seek a change to the NTS exit capacity allowances they receive through their gas distribution network (GDN) price control. They consider that the revised merit order will increase the NTS capacity charges they pay. This would lead to a step change in the charges paid by their distribution customers when the impact of the increased NTS charges are passed through to them. UNC517A would allow WWU to propose a change to their GDN price control settlement to smooth out these impacts.

UNC517B proposes to calculate NTS entry and exit capacity charges on a three year rolling average. This would change the existing arrangement of setting them for the current charging year. SSE consider this will minimise charging volatility as a result of implementing the revised merit order.⁷

UNC Panel⁸ recommendation

At the UNC Panel meeting on 20 August 2015, a majority of the UNC Panel considered that UNC 517/A/B would not better facilitate the UNC charging methodology objectives and the Panel therefore did not recommend their approval.

Our decision

We have considered the issues raised by the modification proposal and the Final Modification Report (FMR) dated 20 August 2015. We have considered and taken into account the responses to the industry consultation on the modification proposals which are attached to the FMR⁹. We have concluded that:

- implementation of the modification proposals will not better facilitate the achievement of the Relevant Charging Methodology Objectives of the UNC.¹⁰

⁵ This data was compiled by NGGT. It shows the proportion of overall gas flow flowing from LNG facilities and mid-range storage sites on the highest demand day in each gas year.

⁶ The FMR outlines implementation dates based on when we approve UNC517A.

⁷ Where less than three year data is available, capacity charges will be averaged using whatever number of years of charges has been published. Where no historical charging data is available, the applicable charge will equal the charges generated for that year.

⁸ The UNC Panel is established and constituted from time to time pursuant to and in accordance with the UNC Modification Rules.

⁹ UNC modification proposals, modification reports and representations can be viewed on the Joint Office of Gas Transporters website at www.gasgovernance.co.uk

¹⁰ As set out the Gas Transporter Licence <https://epr.ofgem.gov.uk/Content/Documents/Standard%20Special%20Condition%20-%20PART%20A%20Consolidated%20-%20Current%20Version.pdf>

Reasons for our decision

We consider these modification proposals will not better facilitate UNC Relevant Charging Methodology Objectives (a), (aa), (b) and (c) and have a neutral impact on the other Relevant Charging Methodology Objectives.

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

and

(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

The proposers contend that implementing any of the modifications would further both of these relevant objectives as they would align the merit order with current supply source utilisation. Some members of the UNC Modification Panel agreed that all three modification proposals could facilitate relevant objective (a) because each would align the merit order with current NTS utilisation and generate more cost reflective charges. The UNC Modification Panel considered that the modifications would have a neutral effect on relevant objective (aa) as the impact on reserve prices will still apply the same rules to all NTS users.

The majority of respondents to the consultation considered implementing UNC517, UNC517A or UNC517B would have a negative impact on both of these relevant objectives.

UNC517, UNC517A and UNC517B propose to implement the same merit order based on the information provided by NGGT in Table One. In our view, the analysis provided by NGGT does not provide robust justification that the revised merit order would better reflect NTS supply source utilisation and, as a result, produce more cost reflective charges.

In particular, the analysis does not demonstrate that there has been a fundamental or structural shift in LNG and MRS supply that would justify creating a single LNG/MRS group. We consider the supply data from both sources shows too much variation over time to justify adequately the proposed change to the merit order.

Furthermore, the analysis in the FMR did not fully provide reasons which could explain the trends shown in Table One. The FMR contains one reference to the use of LNG in

Japan. The analysis provided only limited views on whether the impacts were short term or longer term changes to NTS supply source utilisation.

We note that several stakeholders suggested that the analysis carried out by NGGT was based on an incorrect methodology. There are a number of approaches NGGT could have taken to analysing NTS supply source utilisation. It was NGGT's responsibility to develop and justify the appropriateness of the methodology they chose to use. Our concern is that the analysis provided is not sufficiently robust to demonstrate that the change to the merit order is justified. For these reasons we do not consider that UNC517, UNC517A and UNC517B better facilitate relevant objective (a) or (aa).

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

The proposers state that UNC517, UNC517A and UNC517B will impact on Relevant Charging Methodology Objective (b). Some workgroup participants believed that UNC517A and UNC517B would take into account changes in supply since the merit order was last revised resulting in a positive impact on this relevant objective.

Another participant considered that NGGT's analysis should have been based on a 1 in 20 peak day demand assumption. As a result, they thought the revised merit order did not use the correct methodology to identify LNG and MRS gas flows.

The majority of consultation respondents considered UNC517, UNC517A and UNC517B would have a negative impact on Relevant Charging Methodology Objective (b).¹¹

Our view is that any attempt by NGGT to revise the merit order should be open and transparent so that the charging impacts are fully identified. In this case, we recognise that NGGT, the other proposers and the workgroup participants did attempt to identify the effects of changing the merit order on users across the NTS.

However, we consider implementing the modifications would not better facilitate this objective because of the concerns outlined above with respect to relevant charging objective (a). More evidence needed to be produced to demonstrate enduring changes in the supply of gas from LNG and MRS sites to justify pro-rating supplies from a single group.

(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

The proposers considered UNC517, UNC517A and UNC517B would have a positive impact on Relevant Charging Methodology Objective (c). Workgroup attendees noted

¹¹ One respondent thought all three modifications had no impact on the relevant objective and another respondent said the impact of all three modifications was not clearly positive or negative.

UNC517 and UNC517A would better facilitate competition as the merit order would be better aligned with the costs of operating the NTS.

The majority of respondents to the consultation believed UNC517 and UNC517B would have a negative impact on this relevant objective. Respondents were evenly split on UNC 517A with four each believing the impact would be positive or negative.

Some members of the UNC Modification Panel believed UNC517, UNC517A and UNC517B have the potential to facilitate the relevant objective in that they could improve cost reflectivity which would facilitate competition. In addition, it was noted UNC517B could improve the charging predictability and stability which would facilitate competition.

We agree that a merit order which reflects NTS supply source utilisation more closely will help facilitate competition by ensuring NTS charges are calculated to reflect the actual supply of gas to the NTS. The evidence provided in the FMR demonstrates that changing the merit order can have an effect on the NTS charges users pay, resulting in increases or decreases compared to previous indicative charges. These effects can be felt by specific groups of NTS users, or users in specific geographic areas of the NTS. We accept such distributional impacts can be justified and will facilitate greater competition where it is clearly demonstrated that changes to the merit order will result in charges more closely reflecting real world NTS supply flows.

However, as outlined in our discussion against relevant charging objective (a) above, we consider the evidence provided does not demonstrate sufficiently that the revised merit order will more closely reflect current NTS supply source utilisation on an enduring basis than the current merit order does. This means we cannot be certain that the charging impacts estimated to occur with these changes would facilitate competition. It could result in some users paying higher charges based on a merit order which may not better reflect NTS supply source utilisation. It could also mean other NTS users would benefit from lower charges which would place them at an unfair competitive advantage.

On that basis, we do not consider implementing UNC517, UNC517A and UNC517B would better facilitate relevant objective (c).

Decision notice

In accordance with Standard Special Condition A11 of the Gas Transporters licence, the Authority has decided that modification proposal UNC 517/A/B: 'Review of the Supply Matching Merit Order in Setting Capacity Charges' should not be made.

Rob Mills

Head of Gas Transmission, Gas Networks

Signed on behalf of the Authority and authorised for that purpose