

CadFeb20

**Date**

21 Feb 2020

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Gas Systems, Energy System Transition

Ofgem

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**Consultation on the proposed amendments to Gas Transmission Charging  
Regime: Minded to decision and draft Impact Assessment**

Dear David / Alsarif,

We welcome the opportunity to respond to Ofgem's Consultation. Please see our response below which is non-confidential and can be published on Ofgem's website.

**Questions**

Please provide evidence and analysis to support your responses.

**Question 1**

**What is your view of our assessment that Postage Stamp is a more appropriate RPM in light of the circumstances of the GB network?**

**In responding to this question please address in particular, the following points in your response: (i) in a meshed network with spare capacity and declining usage, a fair approach to cost recovery would be based on the level of access to the system irrespective of individual location; and (ii) CWD may introduce signals for use of the network which discourage flows at more distant entry and exit points, without improving network efficiency.**

In our original response we stated our support for Capacity Weighted Distance (CWD) as being the most cost-reflective approach as both distance and size of load are taken into consideration, and we do still consider this to be the case. In light of some of the information that has come to the forefront through this consultation though, we do now appreciate some of the benefits of Postage Stamp (PS).

We do not agree with the statement in (i) above as by 'meshed', we assume you are referring to the robustness of an integrated Network that benefits from multiple sources of Supply? This is not strictly true as National Grid NTS do not assume all of their Supplies are available at the same time, which is why they run a number of different scenario's.

We remain in support of CWD as being the more appropriate Reference Price Methodology (RPM), even in light of the changing circumstances of the GB network. In our opinion, Distance is and will continue to remain, a significant factor of the charging regime.

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The distance between Entry and Exit points is a key indicator utilised in the determination of the level of investment required to flow gas at a specific point. Under existing rules when a User requests an increase to Enduring levels of NTS Exit (Flat) Capacity that remain within the Obligated amount, in order to mitigate against investment, Substitution is employed (as per the Exit Capacity Substitution and Revision Methodology Statement) and it is Distance that aids the decision-making process in determining potential Donor Points i.e. the furthest away from the Recipient will be considered as the priority.

In recent years, we have seen a growing reliance on the use of Substitution and we believe that this trend will continue for the foreseeable future. We therefore, suggest that Distance will continue to play a significant role in the delivery of Capacity requests and that CWD is the more appropriate RPM, not PS.

With regard to point (ii) we would suggest that the signals mentioned already exist and are in place under the current charging regime, but that the introduction of PS would remove them, thus encouraging flows at more distant Entry and Exit points. This would not necessarily improve Network efficiency as other Entry and Exit points may be discouraged from flowing as a result of increased network charges.

## **Question 2**

**Do you agree with our assessment that maintaining the FCC methodology in the UNC improves the transparency and consistency of governance compared to maintaining the FCC Methodology outside of the UNC?**

Yes, we do. For a number of years now, Cadent has expressed the desire for the various Capacity related Methodology Statements to move to the governance process provided under the UNC. We consider the governance under the UNC process to be far more effective and efficient and therefore, are in support of this approach.

## **Question 3**

**What is your view on our assessment that the PS RPM would be preferable to the CWD for future green gas market entrants?**

This will clearly depend upon the desired location of the gas entry point and whether the resultant Exit charge is lower or higher than CWD. Access to Capacity may still be an issue (depending upon location), but overall, we still consider CWD to be preferable to PS.

## **Question 4**

**What are your views on our assessment of the quantitative analysis?**

The approach taken is similar to that of Cadent in that we considered the key variable components of the core methodology change, and how these were treated in each of the modification variants. This allowed us to narrow down the options through a process of elimination.

We appreciate the difficulties experienced with modelling, particularly where the use of forecast data is involved. You have stated where assumptions have been made, so this helps with our understanding.

We note the use of the Two Degrees scenario (NG FES 2019 Report) as the central scenario for consideration. Cadent has consistently adopted the Steady Progression scenario, so this may result in a difference in charges recovered through the RPM compared to the forecast.

## **Reference Price Methodology (RPM)**

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As stated above, we have previously indicated support for CWD and continue to favour this RPM over PS.

### **Forecasted Contractual Capacity (FCC)**

Cadent believes that the proposed FCC approach for GDNs would provide the best forward projection of actual bookings if it utilised the latest available information. This would result in more appropriate reserve price calculations with a reduced need for revenue recovery mechanisms.

An FCC based upon Annual Capacity Bookings (for the GDNs) should result in more stable NTS charges when compared to an FCC based upon Actual Flows.

We are in support of the FCC Methodology being contained within the UNC.

### **Reserve Price: Firm and Interruptible**

We support a discount of 10% but recommend that this is reviewed periodically as although the possibility of Interruption is quite low, the impact could be high.

### **Reserve Price: Specific Discounts**

We are in support of the minimum level of discount required by EU TAR of 50%. Storage provides a security of supply in extreme events therefore it seems appropriate to apply a level of discount. Any discount above 50% needs to be fully justified so the minimum discount of 50% is appropriate.

### **Revenue Recovery**

We believe that a capacity-based charge promotes stability and certainty in revenue collection, and therefore minimises in-year over/under recovery. We consider that the charging methodology could be further enhanced at a later stage by introducing over/under recovery adjustments targeted to the Entry and Exit Points that have driven the variance. This should help to reinforce the desired predictability in Booking behaviour.

### **NTS Optional Charge (NOC)**

To the extent that Users subscribe to the Optional Charge, the discount provided is absorbed by other Users. Growth in the uptake of the Optional Charge, coupled with its parameters being anchored to a historical point in time creates cross-subsidy between User Classes. We therefore, do not support the retention of this charge.

### **Question 5**

#### **What are your views on our assessment of the modification options presented to us against the applicable UNC objectives?**

Objective (c) Efficient discharge of the licensees' obligations and CMRO Objective (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.

We agree that both 0678 and 0678A achieve certain objectives, including cost-reflectivity and non-discrimination, relative to the status quo. By replacing the existing LRMC methodology, one will be adopted that is more suited to cost recovery given the changing characteristics of the NTS. Unjustified discounts on the reference price will not apply under the proposals, thereby removing a discriminatory element.



Objective (g) 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 and CMRO Objective (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.

Cadent is of the opinion that both 0678 and 0678A are compliant with the TAR NC and therefore, satisfy this objective.

#### Question 6

**What are your views on our conclusion that only two modifications - UNC678 and UNC678A - are compliant with the relevant legislation? If you disagree, please provide a fully reasoned explanation.**

We agree with the conclusion that only 0678 & 0678A are fully compliant with the relevant legislation. The remaining alternates fail to satisfy the requirements due to the reasons stated in paragraphs 6.25 to 6.31.

#### Question 7

**a) Given our conclusion that only two modifications are compliant with the relevant legislation, what are your views on our minded-to decision to approve UNC678A rather than UNC678?**

From a GDN perspective, there is very little to choose from between the two options. The only standout difference being the choice of Reference Price Methodology.

It is important to examine the impact to domestic bills under the two methodologies. The below table forecasts the impact to average domestic bills for the four networks if 0678 or 0678A are implemented. The forecasts are based on prices coming into effect from October 2020 in line with the Minded to position from Ofgem. The prices from National Grid's sensitivity tool ('Sensitivity Tool (Model) 0678 V3.1 CWD Transmission Services (21 March 2019)) published on the Joint Office website have been utilised to develop the forecast.

The table shows a variation between networks, with the customers in the East of England seeing the most considerable increase whereas customers in the North West will see the biggest reduction in domestic bills under both 0678 and 0678A. The Postage stamp approach results in a more significant price increase in East of England and London compared to the CWD approach.

Average Domestic Bill Impact £ (Nominal)							
Network	Methodology	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26
East of England	0678 (CWD)	1.05	1.93	1.91	2.05	2.03	2.04
	0678A (PS)	1.79	3.42	3.43	3.57	3.54	3.56
London	0678 (CWD)	0.4	0.5	0.5	0.6	0.6	0.6
	0678A (PS)	0.6	1.0	1.0	1.1	1.0	1.1
North West	0678 (CWD)	-1.9	-4.5	-4.8	-4.5	-4.5	-4.5
	0678A (PS)	-1.9	-4.4	-4.7	-4.4	-4.5	-4.5
West Midlands	0678 (CWD)	-1.0	-2.4	-2.5	-2.4	-2.4	-2.4
	0678A (PS)	-0.4	-1.1	-1.3	-1.2	-1.3	-1.3

Positive values represent an increase in domestic bills and negative values represent a reduction in domestic bills

Given the arguments presented (resulting in marginal benefit of PS over CWD) we are unable to justify the increase in charges to our Customers under PS over and above those



forecast under CWD. We therefore, do not agree with the minded-to decision to approve 0678A rather than 0678. Cadent continues to support 0678.

**b) Do you consider our minded-to decision to appropriately reflect the principles-based assessment and quantitative analysis presented in this report?**

The principles-based approach is one similar to that taken by Cadent in its original response to UNC Modification 0678. We therefore, appreciate this approach and consider the minded-to decision as one that appropriately reflects each of the elements outlined.

The quantitative analysis carried out is very detailed and thorough. The report published by CEPA goes into great length in covering the various elements that can influence the outcome of the proposal.

Taking the above into account, coupled with our views on the 'meshed' Network and the use of the Two Degrees scenario over Steady Progression, we believe there is little to choose from between the two options, 0678 and 0678A. When considering the RPM, our preference remains with CWD, so we favour 0678 over 0678A.

**c) Do you agree it best facilitates the relevant objectives?**

We would suggest that 0678 best facilitates the relevant objectives as the CWD RPM takes into consideration Distance, whilst the PS RPM completely ignores this element. We therefore, consider CWD to be more cost-reflective than PS.

**Please fully justify your response.**

**Question 8**

**What are your views on our assessment that the proposed RPM (PS under UNC678A) achieves, inter alia, the following objectives:**

**a) enables network users to reproduce the calculation of reference prices and their accurate forecast;**

**i** We agree with this statement but, would also state that CWD achieves the same.

**b) presents a better option than CWD for the recovery of the costs of the gas transmission system in the presence of a meshed network characterised by spare capacity and declining usage, and where cost-reflectivity is less relevant;**

**i** We agree that the PS RPM presents a better option than CWD for the recovery of costs. Not because of the presence of a 'meshed' Network, but because (in the case of Cadent) it results in higher overall NTS Exit Charges. It follows therefore, that there will be a reduced requirement for revenue recovery mechanisms.

**c) ensures non-discrimination and prevents undue cross-subsidisation (you may refer to the results of NGGT's Cost Allocation Assessment ("CAA") published as a subsidiary document to this consultation);**

**i** We agree that the PS RPM better achieves these objectives than CWD. Although both proposals remove the NTS Optional Charge, the PS RPM better effects non-discrimination by applying a single rate across all Entry and all Exit Points.

**d) ensures that significant volume risk related particularly to transports across an entry-exit system is not assigned to final customers within that entry-exit system;**

**i** Agree with this statement as any risk will be smeared across the whole System, rather than being confined within a particular Entry-Exit System.



**e) ensures that the resulting reference prices do not distort cross-border trade?**

We have nothing to add on this.

#### **Question 9**

**What are your views on our minded-to decision that implementation should take place from 1 October 2020 to coincide with the start of that gas year?**

We would support the decision for implementation to take place from 1<sup>st</sup> October 2020 provided all Parties are given sufficient notice of the charges to be used. We would expect the appropriate charges to be published in the NG Transportation Charging Statement due in April 2020.

#### **Question 10**

**Are there any other matters, whether or not addressed in our analysis or minded-to findings, which you think we should take into account in reaching our final determination?**

We believe that an unintended consequence of the minded to decision is that by adopting the PS RPM, the DN Capacity Outputs Incentive will be severely restricted in its effectiveness. One of the key principles behind the incentive was for Gas Distribution Networks (GDNs) to book capacity in the most efficient manner. In order to do this, the GDNs would consider the signals provided by NTS, namely the NTS/LDZ Offtake Exit Charges, and book capacity accordingly.

By applying a single rate across all Exit Points, this signal will now be removed, potentially leading to a change in behaviour that we do not believe has been considered thus far.

In addition, we believe that there may potentially, be a knock-on effect upon the Operational Strategy/Asset Investment programme of NG NTS. By adopting the PS RPM and removing the variance in price signals used by GDNs to book capacity in an efficient manner, this may lead to GDNs operating their Networks (and therefore, booking capacity) in a totally different manner to how they do now. This has the potential to significantly impact NG if, for example, a GDN decides that there is no-longer any incentive to operating 'North to South', but instead find value in flowing the majority of flows from Southern offtakes. How will this impact NG e.g. use of Compressors? Have NG been consulted on this potential change in behaviour from GDNs? If not, then we believe that this discussion should take place together with a thorough impact assessment before a decision on this consultation is made.

#### **Summary**

Having now considered all of the material provided through this consultation, Cadent is of the opinion that there is very little benefit in adopting PS over CWD. On the one hand we can see the benefit to our 11 million Customers collectively seeing lower bills that would be achieved through the CWD RPM. On the other hand, there is some value to be gained by the whole gas industry through the adoption of the PS RPM.

We believe the CWD approach to the RPM to be of greater value than PS and therefore, cannot support the adoption of PS. This response is made on behalf of Cadent and can be published by Ofgem. If you have any further questions, please do not hesitate to contact me using the details at the top of this letter.

Yours sincerely



By email

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