Interconnector (UK) Limited
10 Furnival Street · London · EC4A 1AB · UK
DD +44 20 3621 7839
T +44 20 3621 7800
pavanjit.dhesi@interconnector.com
www.interconnector.com
@IUK_Ltd

David O'Neil,
Head of Energy System Transition
Gas Systems
Office for Gas and Electricity Markets
10 South Colonnade
Canary Wharf
London
E14 4PU

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Dear David,

UNC678/A/B/C/D/E/F/G/H/I/J: Amendments to Gas Transmission Charging Regime: minded to decision and draft impact assessment

Thank you for the opportunity to respond to the Ofgem consultation, dated 23rd December 2019, on proposed amendments to the Gas Transmission Charging regime.

Background

Interconnector UK Ltd (IUK) is a physically bi-directional Transmission System Operator, connecting to the National Transmission System (NTS) at the Bacton Interconnection point (IP). It is required to bundle capacity with National Grid (NG) under the CAM[1] code. National Grid's charges and incentives therefore have a direct and material impact on cross border flows and bookings on IUK.

[1] Commission Regulation (EU) 2017/459 of 16 March 2017 establishing a network code on capacity allocation mechanisms in gas transmission systems and repealing Regulation (EU) No 984/2013

IUK response to the specific consultation questions

Outlined below are IUK's comments on the specific questions outlined in Ofgem's minded to position:

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?

IUK believes a capacity weighted distance (CWD) approach is more appropriate than the postage stamp (PS) approach. Distance is a key cost driver for networks. CWD is more cost reflective than PS and thus furthers compliance against this key objective for tariff determination. The PS methodology creates cross subsidies with points on the network with shorter distances from entry to demand. The analysis by CEPA also suggests adopting a CWD approach benefits GB consumers greater than the PS methodology. The table presented on p7 suggests the net present value to consumers is estimated to be £50m (period 2020-31) greater from implementing CWD over PS. This is not immaterial.

With respect to incremental investment, whilst it is true there is less of a need to expand the network going forward, there is nevertheless still demand for incremental capacity as show by the number of PARCA[2] applications. A PARCA request in 2019 at Milford Haven, for example, has indicated an incremental obligated entry capacity request of 163GWh/d. We believe therefore that moving from a Long Run Marginal Cost (LRMC) to CWD is sufficient to address the changing circumstances of the GB network whilst still ensuring a cost reflect pricing approach.

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. The FCC methodology is a key component in deriving prices. Estimating future bookings is however uncertain. Shipper booking behaviour under the new charging regime is unclear and we have already seen the market moving more and more to booking shorter products. It is important therefore that the FCC is reviewed and the methodology refined, as necessary, once there is more experience of the new charging regime. Having the methodology in the UNC can improve transparency on this key component.

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 is not clear. On p64 Ofgem suggest that the PS is preferable because it leads to predictable and stable charges. However predictable and stable charges can just as easily be achieved under a CWD approach. The key factor in achieving this, whatever the methodology, will be the accuracy of the FCC.

[2] https://www.nationalgridgas.com/connections/reserving-capacity-parca-and-cam.

Question 4: What are your views on our assessment of the quantitative analysis?

As noted earlier, we observe CEPA's assessment suggests a greater NPV benefit for consumers from adopting UNC678 (CWD) than UNC678A (PS).

In terms of the impact of tariffs, we note you have shown a comparison of annual tariffs e.g. figure 0.7. Whilst this suggests both CWD and PS results in lower prices than today, it would be more appropriate to compare the cost of short-term products. Today short-term prices are heavily discounted, and the optional commodity charge can also be used further reducing the commodity cost element. Even with this incentive changing, with a multiplier of 1 and unconstrained capacity we can imagine shippers booking capacity short term if they have the opportunity to do so. For IPs it is therefore more relevant to compare shorter term products like daily prices than annual tariffs. Looking at daily charges this way would show the PS results in higher charges than today.

Question 5: What are your views on our assessment of the modification options presented to us against the applicable UNC objectives?

We believe the CWD methodology, by being more cost reflective relative to the PS methodology, furthers the efficient and economic operation of the network. It is also more likely to facilitate cross border trade given IP tariffs at Bacton would be lower than derived from the PS methodology.

We also agree that UNC678 and UNC678A are both compliant with the TAR NC and therefore better facilitate Objective (g).

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.

A key element missing in UNC678 and UNC678A is a capacity short haul tariff to replace the current optional commodity charge. Whilst it is clear the current structure of the optimal commodity charge could not continue, we believe UNC678D, which has sought to create a more limited capacity discount is also compliant and could be considered as a temporary measure pending the conclusion of UNC670R. As present it is looking extremely challenging for any UNC proposal coming from UNC670R to be implemented by October 2020.

The optional commodity charge has been in place for over 20 years and investments decisions have been taken in that time based on a legitimate expectation that a bypass avoidance tariff will remain. It remains appropriate and fair for short haul to continue, in some form, from October 2020. As well as making contributions to NTS costs, short haul has proven to make a wider contribution to the GB gas market by helping encourage gas into the GB market and GB exports. There is a risk that without any short haul tariff we see less bookings and activity which consequently reduce the actual level of revenues received, resulting in high charges. NOC methodology 2, combined with CWD has been shown in CEPA's analysis to move in the direction of limiting scope of the current levels of discount. It therefore furthers the relevant objectives relative to today and could be considered as a temporary solution until the UNC670R process and its resultant modification proposals process have been concluded.

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

For the reasons already given, IUK support approval of UNC678 over UNC678A given CWD is more cost reflective.

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;

Both modifications equally enable users to reproduce the calculation of reference prices for October 2020. However, given the uncertainty about shipper booking behaviour under the new charging regime, neither modification proposal enables the accurate forecast of future prices.

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;

We disagree. As mentioned earlier CWD is more cost reflective than PS and is shown to benefit consumers more. Cost reflectivity remains relevant and distance remains a cost driver so remains an element in determining charges.

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);

PS does create undue cross subsidisation by increasing the charges for users of points closer to demand. We believe a CWD approach is more justified.

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

A CWD approach being more cost reflective does not distort cross border trade. A PS methodology results in higher prices than the CWD approach for interconnectors (figure 0.7) and LNG important terminals (figure 0.5). CWD is likely therefore to be relatively better for cross border trade.

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 welcome implementation from the beginning of the gas year in October 2020.

Uncertainty about the NTS charging regime and when prices could change have had a knock-on impact to interconnector bookings. Shipper have consistency cited uncertainty about NTS charges as a reason for delaying bookings and looking at shorter term options. The indication from Ofgem that implementation is proposed from October 2020 has already helped cross border transactions this year by providing confidence the current NTS charging regime will continue until the end of September.

Whilst we support implementation from the beginning of the next gas year, we urge Ofgem to make its decision by May 2020 to ensure tariffs are clear and known before IP capacity is offered for the next gas year. As you will be aware, under the European tariff network code, NG and its adjacent TSOs are required to publish their annual prices a month before the annual CAM auction (held in July). They are also required to publish their multipliers for the shorter-term CAM products for the next gas year in May. Quarterly CAM products for all the coming gas year are also offered in August. Any uncertainty about NG's prices may hinder participation in these auctions and thus hinder cross border trade with a knock-on impact to the interconnectors.

If you wish to clarify anything in our response, please do not hesitate to contact me.

Yours Sincerely

Pavanjit Dhesi
Regulatory Affairs Manager