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Dear David,

We welcome the opportunity to respond to Ofgem's Impact Assessment on the proposed Amendments to the Gas Transmission Charging Regime advocated by UNC Modification Proposal 0678 and its Alternatives. This response is provided on behalf of National Grid Gas plc ('NGG') which owns and operates the gas National Transmission System.

NGG supports the conclusions of the Impact Assessment including the observations in respect of the extent of compliance (of each of the Proposals) with the EU Tariff Code (EU Regulation 2017/460). We recognise that Ofgem's 'Minded-to' decision and the comments on implementation provide an acceptable way forward to deliver a revised Gas Transmission Transportation Charging Methodology which is better aligned to future regulatory and commercial market conditions. The prospective Methodology will be kept under review and updates considered on a periodic basis, or as required, over time (for example in accordance with EU Tariff Code provisions).

NGG would urge Ofgem to reach its final decision on these Proposals at its earliest convenience in order to enable effective implementation by the proposed implementation date of 1st October 2020. Timely certainty regarding the prospective arrangements will enable progression and finalisation of the work to prepare the central systems and processes for implementation. It will also allow market participants to finalise their respective analysis of any changes required to their individual systems and processes.

Alongside this, NGG will continue to progress work towards incorporation (into the prospective Gas Transmission Transportation Charging Methodology) of a means to manage the risk of inefficient bypass of the NTS. This is based on the expectation Ofgem will direct the implementation of one the two Proposals Ofgem concluded as being compliant with the EU Tariff Code (0678 and 0678A), neither of which include such a mechanism. Clearly, if Ofgem directs the implementation one of the other Proposals, the continued progress and ongoing need for this work will need to be re-assessed.

The need to make changes to the Gas Transmission Transportation Charging Methodology was driven by several factors; notably to ensure compliance with the EU Tariff Code and improving the Charging Methodology so it is more relevant to access and use of the NTS. Reasons why we believe the Methodology would be more suitable under the proposed minded to position is the emphasis on capacity charging and a establishing a charging framework that has more appropriate discounts, alternative charging or exemptions and pricing which is better reflective of the relevant objectives of the charging methodology. NGG has led the industry development of proposals to deliver change to the charging

regime that better suits the current and anticipated market conditions and ensure compliance with the EU Tariff Code.

In June 2017 NGG raised UNC Modification Proposal 0621 and during Workgroup development of this solution a further ten Alternatives were raised. However, due to EU Tariff Code compliance concerns, Ofgem did not direct the implementation of any of these Proposals. In January 2019 NGG raised UNC Modification Proposal 0678 within which we sought to address the compliance concerns previously expressed by Ofgem in respect of the previous Proposals. Recognising the need to ensure compliance with the EU Tariff Code as soon as practicable, NGG sought the application of Urgent UNC governance procedures for this later Proposal. Again, during the development of this Proposal a further ten Alternatives were raised.

UNC Modification Proposal 0678 and all its Alternatives advocate changing the existing Long Run Marginal Cost (LRMC) capacity reference price methodology (RPM) to either a Capacity Weighted Distance (CWD) or a Postage Stamp (PS) model to recover revenue associated with Transmission Services. Both of these proposed RPMs adopt a "top-down" approach to delivering a means of apportioning revenues across a determined capacity value but differ in their use, or otherwise, of location specific capacity and distances. The PS delivers a uniform price for all points regardless of distance or location, however, CWD uses both distance (average shortest paths) and location (entry and exit point) to derive reference prices.

NGG notes Ofgem's observations and comments on Cost Drivers concluding that due to specific market conditions related to NTS access and use, it can more suitable to have PS over CWD. The EU Tariff Code Article 4(1)(a) states that a service is classified as a Transmission Service where costs are caused by, in some combination, capacity and distance. PS only uses a single aggregate capacity driver for Entry and Exit, CWD uses point specific capacity and average (shortest path) distances. As part of the overall methodology, the use and application and relevance of cost drivers will be kept under review and may inform future changes as appropriate.

NGG supports the observations given on PS and CWD being a 'top down' methodology to recover revenues, by comparison to LRMC, which places less emphasis on 'forward signals' and more on network access and usage which could be considered more a 'revenue recovery' model. Arguably the LRMC methodology, through the nature of its calculation and adjustments, no longer reflected its purpose, that being to set charges for an ever-expanding network. With a network that has spare capacity, or could be seen to have little scarcity of capacity, a focus on how the NTS is used to its optimal levels, reflective of User's needs, is important and the minded to position, in our view, would support this ambition.

NGG supports implementation of the relevant Modification in October 2020, this being the earliest opportunity to implement this scale of regime change whilst minimising disruption to industry processes which are designed to accommodate a degree of transition at the commencement of each Gas Year (for example price adjustments). Further, as the rules for derivation of a capacity Reference Price contained in the EU Tariff Code apply in respect of a 'Tariff Year' (and the GB Tariff Year is the Gas Year) this implementation timescale will align with this Regulation.

Our responses to the specific questions asked in the Impact Assessment are as follows:

<u>Question 1:</u> 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.

NGG recognises that where a network is not capacity-constrained and Users have the option to flow gas on and off the system at multiple locations there is merit in allowing maximum use of the system which could be encouraged by making the price as equitable as possible i.e. uniform. However, dependant on the level of capacity registered and used at particular points on the network, if demand exceeds supply it may be necessary to review the cost drivers for access to, and use of, the NTS to facilitate optimal access and use of the available infrastructure.

We acknowledge that in cases where CWD RPM derived capacity price is greater than the price derived under a PS RPM this could discourage flows, however as recognised by Ofgem (in the context of network efficiency), there will also be points on the network where the price derived from the CWD RPM will be less than the price derived under the PS RPM hence utilisation of the PS RPM could also discourage flows at entry and exit points which are closer together.

<u>Question 2:</u> 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?

NGG's preference is that the FCC Methodology is governed outside the UNC as advocated by Modification Proposal 0678. Whilst recognising the benefits of transparency afforded by UNC governance, in the case of the FCC Methodology NGG believes it is more appropriate for change governance to be maintained outside of UNC. This would ensure that revisions to the FCC Methodology can be implemented in an efficient and timely manner whilst maintaining sufficient levels of transparency to impacted stakeholders. We maintain concerns that the alternative approach of application of full UNC governance procedures creates the risk that required updates could be frustrated or delayed and adversely impact the responsiveness of the FCC Methodology to changing market conditions or scenarios.

Nonetheless, recognising Ofgem's preference, when the FCC Methodology is inserted into the UNC, we do not believe it should be a 'lift and shift' i.e. incorporation of the FCC Methodology as written. NGG's view is that it is not possible to cater for every scenario and that there will always be a need for NGG, as an independent arbiter without any commercial interest in the FCC values, to apply discretion into the process of determining the forecast capacity values for utilisation in the RPM. Should the FCC Methodology be included in the UNC, a more general set of rules may be more appropriate in order to efficiently manage future scenarios and make for more timely updates via full UNC open governance.

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?

NGG recognises that, comparatively, the CWD RPM will deliver a higher level of price volatility compared to a PS RPM but it is also the case that absolute price differential (between the two RPMs) for an individual point will depend entirely upon location and as identified above, some points will attract a higher price under the PS RPM (compared to the CWD RPM). Accordingly the optimum model from the perspective of individual consumers will depend entirely upon relative value they place on price certainty relative to absolute price level.

We would support the consideration of the regime's impact on green gas market entrants in the aforementioned prospective reviews of the charging Methodology.

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

NGG agrees with the identified impacts on the transportation charges in the event that the underlying assumptions prove to be accurate. Some specific observations and comments are detailed below.

In grouping the options for modelling, the method of grouping the modelled options to assess the modifications together is an efficient approach to allow comparisons of the constituent components of the respective methodologies. We note the indicative nature of the assessment and the number of assumptions necessary to inform the market modelling undertaken and therefore there may be different interpretations or it may not reflect the specifics of all those that may be directly or indirectly impacted, particularly where the assumptions may relate to sensitivities to outcomes in the market.

The price differential between LRMC, CWD and PS provided in the quantitative analysis provides a simple and effective summary of how the respective methodologies produce ranges in tariffs for both Entry and Exit. The summary shows the range of prices being greatest under LRMC, then lower under CWD and for PS no tariff spread (as there will only be one Entry and one Exit price).

We note the assumption applied that market participants would book capacity equal to gas flows. This is not too dissimilar to the FCC Methodology assumptions and approaches National Grid produced for Modification Proposal 0678 (and replicated across all the Alternatives either in or out of UNC) whereby it would make less economic sense under any of the proposed methodologies to book capacity in excess of flows where there is to be a liability for the capacity. Whilst this may not be precise (as there is always likely to be a degree of under or over booking relative to gas flows) this is a still a sensible assumption to make.

In considering the overall consumer welfare impacts, should there be a reduction in the wholesale price and the impacts considered in the assessment, there should be some benefits realised for end consumers. The nature of how the overall revenue is charged downstream from NTS Charging will depend on how other market participants recover transportation charges via their respective charges however we note the market model that CEPA has used takes this into account using assumptions as appropriate.

The NTS Optional Charge assessments will need to consider broader economic assessments and therefore it is reasonable to make generic or high level, broad assumptions as needed. Like with other

assumptions these may not reflective of each market participant and the analysis does provide some useful sensitivities for those parties. We note however that the 'cross-subsidy' relates to the Transmission Services component. Where any of the 0678 alternatives additionally provide an alternative to the General Non-Transmission Services charges the overall cross subsidy across all charges may, as a result, be understated.

The quantitative analysis focuses on the Transmission Services and Non-transmission Services. However, we note that in the case of the latter there are no major structural changes as is the case with the former which is a fundamental change to the RPM that determines the capacity charges.

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

NGG's views in respect of the assessment against the relevant objectives are as follows:

- Objective (g) and Charging Methodology objective (e) *Compliance with the Regulation*
  NGG agrees with Ofgem's conclusions as to which of the eleven Proposals is compliant with the EU Tariff Code and therefore which of the Proposals better facilitate these objectives.

- Objective (a) *efficient and economic Operation of the pipe-line system*; and Charging Methodology objective (b) *takes account of developments in the transportation business*
  NGG agrees that replacing the existing LRMC RPM with a CWD RPM or a PS RPM better facilitates these objectives

- Objective (c) *efficient discharge of the licensee's obligations*; and Charging Methodology objective (a) *charges which reflect the costs incurred by the licensee in its transportation business*
  NGG agrees that the cost reflectivity of charges is improved by implementation of either the PS RPM or the CWD RPM compared to the existing LRMC RPM baseline. As highlighted elsewhere in this response distance-based signals (absent in the PS RPM) are less relevant where is an abundance of capacity in the network, however, should greater levels of competition for accessing the network arise we believe that use of the CWD RPM (which has more bespoke cost drivers) may be more appropriate in order to provide the commercial signals to drive optimal use of the network.

- Objective (d) and Charging Methodology objective (c) *securing of effective competition*
  NGG agrees that a number of the Proposals include inappropriate or unjustified discounts which would not better facilitate these objectives

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.

NGG supports Ofgem's conclusions in respect of compliance of each of the Proposals with the EU Tariff Code.

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?*
b) *Do you consider our minded-to decision to appropriately reflect the principles-based assessment and quantitative analysis presented in this report?*
c) *Do you agree it best facilitates the relevant objectives? Please fully justify your response.*

NGG's views in respect of each are as follows:

a) NGG welcomes the minded to decision as we believe that implementation of the CWD or PS RPM would represent a significant improvement to the current LRMC RPM. Accordingly we support either 0678 or 0678A being implemented. Whilst our preference remains 0678 for its additional use of cost drivers, we recognise the rationale stated for favouring implementation of 0678A in the context of the *current* usage of the network

b) NGG believes that the minded-to decision appropriately reflects the principles-based assessment and quantitative analysis presented in the report

c) As noted above, NGG recognises the rationale for favouring 0678A in the context of the *current* usage of the network. We agree that implementation of this Proposal would better facilitate the identified objectives compared to the current baseline.

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

NGG's views in respect of each are as follows:

a) NGG agrees that the Methodology is clearly stated and would therefore enable Users to replicate the calculation of Reference Prices

b) NGG agrees that, on the basis of the extent of network usage identified, cost reflectivity is less relevant.

c) NGG agrees that as 0678A does not feature any unjustified discounts nor inappropriate treatments this solution is non-discriminatory and would not provide undue cross-subsidisation

d) NGG agrees that the proposed arrangements do help ensure that transportation costs are appropriately targeted. Under the current regime the availability of the NTS Optional Commodity Rate at the Moffat Interconnector results in socialisation of costs (of exports to the island of Ireland) to GB consumers. Removal of the availability of discounted transportation charges (and more equitable capacity pricing) at this point would removes this inappropriate cross-subsidisation.

e) NGG do not believe the proposed arrangements will distort cross border trade as the new Methodology delivers a regime that is compliant with the EU Tariff Code which is equally applicable in EU Member states including those with direct interconnection with GB.

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?

NGG supports implementation taking effect for charges levied from 1st October 2020. We would note that other complementary changes to the new Gas Transmission Transportation Charging Methodology should (if approved) be considered for implementation in the same timescale where practicable.

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?

Whilst not impacting directly on Ofgem's decisions in respect of the 0678 suite of Proposals, we would highlight the ongoing work to incorporate into the Gas Transmission Transportation Charging Methodology a means of avoiding inefficient bypass of the NTS. In addition, given Ofgem's observations regarding an increased storage discount (compared to that proposed by 0678 and 0678A), we would anticipate that a Proposal for such an increase may be forthcoming.

250 word summary, for the purposes of the EU Article 26 Consultation

The existing Gas Transmission Transportation Charging Methodology is not fit for purpose as it does not deliver stable and predictable transportation charges and is not complaint with the EU Tariff Code. NGG has led industry development of proposals to deliver change to the Methodology via UNC Modification Proposals 0621 and 0678, the latter seeking to address the concerns expressed by Ofgem regarding the compatibility of 0621 with the EU Tariff Code.

NGG supports the conclusions of Ofgem's Impact Assessment including the range of indicative Reference Prices stated. In respect of the objectives of the Charging Methodology, we recognise that in an under-utilised system cost reflectivity can be less relevant, therefore implementation of a PS RPM better facilitates the relevant objectives compared to the current LRMC RPM baseline.

We support the need to move away from the LRMC RPM for the reasons stated above and agree that implementation of 0678A would introduce a Methodology which addresses these issues and is compliant with the EU Tariff Code. NGG also agrees with Ofgem's assessment of the extent of each Proposal's facilitation of the relevant objectives and believe that implementation of 0678A would provide a revised Gas Transmission Transportation Charging Methodology which is better aligned to future regulatory and commercial market conditions.

NGG would urge Ofgem to reach its final decision at its earliest convenience to enable NGG (and the industry) to continue work towards implementation of new arrangements by 1st October 2020 to facilitate compliance with EU Tariff Code as soon as practicable.

If you have any further questions in respect of this response, please contact Colin Williams by telephone on 07785 451776 or by email to colin.williams@nationalgrid.com.

Yours sincerely,

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