

FAO: David O'Neill  
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24th February 2020

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

Dear David,

SmartestEnergy welcomes the opportunity to respond to Ofgem's consultation on the minded to position to approve modification 0678A.

SmartestEnergy is an aggregator of embedded generation in the wholesale market, an aggregator of demand and frequency services, a supplier in the electricity retail market, serving large corporate and group organisations, and a wholesale market access provider for independent suppliers.

Please note that our response is not confidential.

**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?**

The Postage Stamp (PS) methodology applies the same reference price per unit of capacity at all entry and exit points and does not include any reference to the distance between entry and exit points. However, the PS methodology will, on average, result in higher tariffs for entry-exit combinations separated by short distances than CWD as a result of the removal of the optional tariff, which may increase the incentive for bypass of the gas network for those users who flow gas over a relatively small proportion of the NTS. This would appear to be less economically efficient. However, this risk of bypass may be limited given the various challenges that must be overcome.

***(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;***

We would question the use of 'spare capacity' and 'declining usage' in this question, as it is not specified how much spare capacity is available, and how much usage is declining, which can create misleading assumptions.

We agree that the Cost Weighted Distance (CWD) approach, could lead to users in more distant parts of the network paying a greater portion of revenue recovery, which may be

an insufficient reflection of users' contribution towards costs on the NTS. However, the proposed alternative of the Postage Stamp (PS) methodology, is predicted to result in higher tariffs for entry-exit combinations separated by short distances, which could increase the incentive for bypass of the gas network for those users who flow gas over a small proportion of the NTS. This then goes against the 'fair approach' to cost recovery that the PS is trying to achieve. Whilst in the minded-to decision it is claimed the risk of bypass is low, it is unclear in the analysis how this opinion was formed or modelled.

***(ii) CWD may introduce signals for use of the network which discourage flows at more distant entry and exit points, without improving network efficiency.***

Given the spare system capacity created from the CWD approach, this could lead to distortions and be less fair than a PS approach. Additionally, renewable energy developments are typically occurring on sites that are not necessarily close to entry or exit points, so introducing signals that may distort flows from more distant entry and exit points may discourage renewable development. However, as argued above, the PS methodology resulting in higher tariffs for entry-exit combinations separated by short distances, creating incentives for bypass, could also impact network efficiency through creating inaccurate signals as a result of bypass.

**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?**

It is important that we maintain governance relating to the UK Gas Transmission within the existing framework, to ensure that new entrants are not deterred by complex governance structures. This will ensure consistency and negligible changes to process and change methodologies already in place. The UNC provides documentation for Gas participants and is centrally located for ease of use. Therefore, we agree with the current assessed view.

**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?**

We would marginally agree that for this to be preferable. There should be schemes in place in order to provide stability to green gas market entrants. For any new market entrants, this will be a consideration and any lack of subsidy will have an effect on any future decisions. Given that there is an extension until 2021 for the Renewable Heat Incentive, while this would be welcome, in order to effect greater uptake in renewable green gas entrants and in order to meet net-zero targets as well as UNC obligations, there should be schemes in place beyond this deadline.

Therefore, for any preferable minded decision, there are other considerations that will undoubtedly affect the process other than RPM for green gas entrants.

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

No comment

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

***Objective (a) Efficient and economic operation of the pipe-line system and CMRO Objective (b) that, so far as is consistent with sub-paragraph (a), the charging methodology properly takes account of developments in the transportation business***

No comment

**Objective (b) Coordinated, economic and efficient operation of combined pipeline system**

No comment

**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 the LMRC model needs to be replaced in light of the declining use of the network in the future. As the current model was introduced at a time of increased costs due to new parties needing expansion of the network, the current model of decline in the expansion of the network will ultimately lead to a new methodology for charging and recovering revenue costs. Moving from a 'bottom-up' to a 'top-down' method of charging will run in line with the UNC and the meshed nature of the gas network.

In ensuring obligations on effecting competition we agree that any discounts including storage discounts, the Ireland security discount and the NOC methodologies would be discriminatory. We also note that by entering the FCC within the UNC, changes would need to be facilitated as there is no evidence that changes would not be required after a new RPM is implemented. It must also be noted that there is no mention of how future green policies would affect a PS RPM, In light of this, we agree that FCC changes may need to be implemented quite frequently in the future in order to facilitate any future competition.

**Objective (d) Securing of effective competition and CMRO Objective (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, and CMRO Objective (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**

We would agree that the decision aligns with this statement, as competition is best facilitated by tariff arrangements which are non-discriminatory. Those objectives that introduce some form of dual regime (UNC678C/E/F/G/H), capacity surrender rule (UNC678F), or introduce inappropriately targeted discounts to reference prices (UNC678B/D/G/H/I/J) would reflect the objective above to a lesser degree than the two options selected as compliant (UNC678/A), which do not include such features.

#### **Objective (e) Achievement of domestic security of supply standards**

All the proposed modifications would facilitate this objective than the status quo, as they introduce cost-reflective and non-discriminatory tariff arrangements. However, options such as CWD that introduce inappropriately targeted discounts to reference prices (i.e. distance-based) would facilitate the above objective to a lesser extent.

We also note in the consultation document, it is suggested that the inclusion of a storage discount of greater than 50% could help to reflect this objective. We would not support this, as it would create price distortions.

#### **Objective (f) Promotion of efficiency in the implementation and administration of the code**

We consider the impacts of the proposed modifications on the efficiency of implementation and administration of the code to be small in comparison to the wider impacts set out in this report.

**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**

No comment.

**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.**

No comment.

**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?**

We do agree that postage stamp (UNC678A) would appear to be the optimal choice in terms of compliance, it is very unclear at present how this could work or if it could bring any benefits. For example, UNC678A does result in a significant increase in the entry tariff for gas storage, which may negate any perceived benefits. Looking forward, we need clarity on how the postage stamp option would work in the methodology and the practical aspects.

**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.**

No comment.

**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;**

The CWD approach results in undefined or negative reference prices at certain locations, which requires a correction by basing the reference price entry/exit point on the price for the closest non-zero entry/exit point. This makes it more challenging for network users to replicate reference prices accurately. This correction is not required under PS, as the capacity denominator will be an aggregate figure for the whole system and not on the basis of individual points. However, it is still unclear how other factors such as weather and demand may impact reference prices, we find it challenging to understand how reference prices can remain the same at exit and entry points regardless of external factors.

**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;**

No comment.

**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);**

We would marginally agree with this according to the results of the CAA but would emphasise that this is dependent on a variety of different factors, and in some circumstances, subsidies can encourage competition.

**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;**

No comment.

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

The proposed PS RPM does not include features that may be considered to be discriminatory such as discounts or special treatment of revenue recovery exclusions (other than those required by TAR NC). By avoiding discrimination between users, the option is likely to facilitate 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?**

Agree

**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?**

N/A

### **Brief Summary**

We are concerned that PS could increase the risk of bypass, as the methodology has higher tariffs for entry-exit points separated by short distances. Although Ofgem claim that the risk of bypass is low, it is not clear how this opinion was formed and on evidence.

However, CWD could also lead to distortions, through a distance-based charging mechanism. This could also discourage renewable energy developments, which are not necessarily close to entry/exit points and could therefore be a stumbling block in the path to net-zero.

We would marginally agree that PS is preferable for future green gas participants. There are other considerations beyond RPM for green gas participants, such as schemes to promote market stability such as the Renewable Heat Incentive scheme that is due to end in 2021. Whilst the PS does provide some market stability, future schemes will need to be implemented to incentivise green gas participants.

PS is preferable in terms of compliance, as doesn't feature inappropriately targeted reference price discounts, dual regimes, or the capacity surrender rule, which would all not target effective competition. We are concerned about the lack of confidence in modelling, Ofgem comment several times that the limitations and assumptions in the modelling make it challenging to draw conclusions.

PS is also preferable in terms of replicating reference prices, CWD can result in negative/zero reference prices at some locations which requires correction. However, PS does not require this correction.

Should you have any questions regarding our response do not hesitate to get in contact with me.

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