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**RE: Amendments to Gas Transmission Charging Regime: Minded to decision
and draft impact assessment**

Registered in
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Dear David & Alsarif,

Summary

We do not support the implementation of UNC Modification Proposal 0678A. Whilst we agree that the proposal can be considered NC TAR compliant, we are concerned about the impact on the GB gas market of moving to a fundamentally different charging methodology.

Implementation of the proposed Postage Stamp (PS) Reference Price Methodology (RPM), alongside a uniform rate Non-Transmission Services charge, would remove all locational signals from the current charging arrangements. It is not clear to us that despite declining gas demand overall, future connectees will not impose any additional costs on the NTS.

By providing no locational signal or incentive, the PS RPM gives network users no indication about the most efficient place to locate on the NTS. Even if the NTS as a whole is unconstrained, there are areas that present operational challenges to NGG, such as the South East of England. As the proposed charging arrangements will incentivise significantly more firm capacity bookings than at present, we may see a tightening of the network. If new users then connect in such an area, NGG may incur costs, potentially leading to inefficient grid investment. This would be paid for by existing connectees and consumers.

This situation could be avoided by retaining a locational forward looking charge to continue to encourage connections in the most efficient locations, thereby mitigating the risk of inefficient investments. As the Capacity Weighted Distance (CWD) RPM retains some degree of locational charging, we believe that UNC 0678 would be a better outcome for all consumers.

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;

We do not agree that Postage Stamp (PS) is the most appropriate RPM for GB. Furthermore, we find it inconsistent with the approach currently being taken to electricity transmission charging. More specifically, we are concerned that the removal of all locational signals in GB gas transmission charging arrangements could drive cost inefficiencies, for example by incentivising parties to connect anywhere on the NTS, irrespective of the costs incurred by NGG in facilitating this.

Ofgem notes that *“in a declining use network largely operating below capacity, the marginal costs of additional capacity, are, on many parts of the network, close to zero”*¹. Whilst we acknowledge this may be the case, it is important to note that the marginal costs of additional capacity are not zero in all cases. So, whilst the NTS as a whole may be considered unconstrained and having surplus commercial capacity, the NTS cannot be characterised as being free from all constraints in all time periods. For example, the South East of England is often referenced by NGG as a challenging part of the network to manage, with connectees often seeing large fluctuations in pressures provided.

Moreover, the new arrangements, irrespective of RPM, are likely to lead to significantly increased firm capacity bookings, due to the small price difference between firm and interruptible / off-peak capacity. It is, therefore, entirely possible that we see constraints, or at least network tightness, developing in the future. If new connectees then choose to locate in such parts of the NTS (for example, due to a sudden increase in new Hydrogen connections), it is possible that local constraints are caused. If NGG subsequently invests to accommodate the additional flows, or incurs constraint costs in managing them, then it will ultimately be consumers that pay for this.

The charging arrangements can play an important role in helping to avoid this scenario by giving clear forward looking signals that incentivise connections in the most efficient locations. Retaining a forward looking charge would also be consistent with the approach taken under the current electricity transmission charging review. In the absence of such a signal, we believe there is potential for the PS RPM to worsen the situation, as it may inadvertently encourage new connectees to locate in areas that are already challenging to manage, such as the South East of England.

We have an additional concern that the PS RPM disadvantages sites that made rational commercial decisions in the past, to locate in efficient and economic parts of the NTS. This is demonstrated by a significant increase in the Exit tariff for such sites under the PS RPM compared to the LRMC RPM. The impact is particularly pronounced for CCGTs, many of which have located close to Entry terminals over the past 20+ years. In doing so, they have limited or avoided the need for significant infrastructure spend by NGG, thereby providing cost savings for

¹ https://www.ofgem.gov.uk/system/files/docs/2019/12/unc678_minded_to_decision.pdf, page 42

consumers. In the absence of a suitable shorthaul product, it is highly likely that Mod 0678A will incentive these sites to bypass the network. The resulting lost gas flows will result in higher costs for the remaining NTS customers and overall, would represent an inefficient outcome for the GB gas market.

We also have reservations about whether the PS RPM achieves Ofgem's objective of a *"non-discriminatory approach to the recovery of the allowed revenue associated with historical sunk network costs"*. Undue discrimination can arise where all network users pay a uniform price or are eligible for a uniform discount, if they take or provide different levels of service and those costs are not reflected in the price they pay to access the network. We believe this is the case with the PS RPM in the context of the GB gas transmission network. We do not believe that all Users are imposing an equal cost on the NTS. Therefore, the charges that users face should, in our view, reflect the cost of making capacity available to them. We believe CWD overcomes this potential undue discrimination issue by including an element of distance in the charge calculation, as a proxy for the cost of making capacity available. On this basis, we believe that UNC Mod 0678 (based on the CWD RPM) is a better fit for the current and future GB gas market.

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.

We disagree that it would introduce new signals, as CWD is effectively a variation on the existing LRMC methodology, with similar but weaker locational signals. We believe the current (and CWD) methodology gives at least some signal to users that connecting at remote locations will result in greater costs compared to, for example, connecting close to existing NTS infrastructure.

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 agree with Ofgem's view on this matter. It also reflects industry concerns raised during the 0678 development process that the FCC would be under unilateral control of NGG if it sits outside of the UNC. We have a longstanding view that all NGG methodologies should fall under UNC governance and we would strongly support inclusion of the FCC in the UNC at the earliest opportunity.

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 do not believe that in practice, the small differences between the prices derived under the CWD methodology and those under the PS methodology would materially impact on where green gas market entrants would choose to locate, or influence the decision about whether or not to connect to the gas grid. However, if significant volumes of green gas were to connect to the NTS in future, we are concerned that PS RPM would not facilitate this in an efficient manner as it would fail to give signals about the best places to connect.

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

We believe that the quantitative benefits (aside from compliance) are overstated and that the costs to users (particularly CCGT Direct Connects) are understated.

We recognise that modelling all aspects of a charging regime is complex and relies on many assumptions to account for a variety of Shipper commercial strategies. However, we consider that the “Status Quo” as modelled by CEPA does not fully reflect the current GB gas market and therefore the conclusions that are drawn cannot be relied on with complete confidence.

Specific issues that we have observed:

- CEPA’s assumption that bookings equals flows for non-DNs is fundamentally incorrect. Under the current arrangements, particularly at Exit, there is significant over-booking of capacity relative to flows because of the low pricing of Off-peak and short-term Firm Exit capacity. As the new arrangements will incentivise bookings much close to flows, a better starting assumption would have been flows = bookings.
- Excluding current (and future SO-based) costs, particularly in the context of shorthaul has distorted the analysis. As shorthaul users currently do not pay SO Commodity charges, excluding these costs will inevitably impact the likelihood of bypass calculation.
- We disagree with CEPA’s finding that the gas wholesale price is likely to decrease under all options. We find this is intuitively incorrect, due to the loss of shorthaul and the increase in cost of transmission charges for gas storage, a key source of flexibility for the GB market.
- We agree with CEPA’s reflection that: *“it is possible that changes in tariffs affect the [electricity generation] merit order itself. For example, a decrease in the tariff of a unit that was previously outside of the merit order may allow it to come into merit. Similarly, a marginal unit may be pushed out of merit by an increase in its tariff. Any changes in the merit order may increase or decrease the wholesale price, depending on the magnitude of changes in the tariffs of the relevant units”².*

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

We agree that the PS and CWD RPMs are compliant with NC TAR and therefore further the relevant objective of complying with relevant EU Regulation (UNC Charging Methodology Relevant Objective (e)).

We disagree, however, that UNC 0678A will benefit competition between Shippers. In practice, it will have significant redistribution effects arising from the transition between current LRMC and future PS RPMs. We are particularly concerned about the impact this could have on NTS connections which previously located in efficient

² https://www.ofgem.gov.uk/system/files/docs/2019/12/cepa_unc678_analytical_support.pdf, page 33.

parts of the network but now risk being undermined by the introduction of a PS RPM. Equally, sites which have in the past resulted in significant infrastructure expenditure by NGG to enable their connection, will now pay the same as any other site. Completely flat transmission charges for all network users is, in our view, a step too far for the GB arrangements.

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 that both 0678 and 0678A could be considered compliant although we note that throughout the Mod development process, conflicting legal opinions were shared on a variety of issues, which suggests there is room for interpretation of NC TAR.

We support Ofgem's view on the interpretation and application of NC TAR Article 35 (so-called "Existing Contracts"). However, we feel that NGG risks undermining Art. 35 by, in practice, applying Revenue Recovery Charges (RRCs) to Existing Contracts that are traded between Shippers. In our view, bilateral trading of capacity does not change the contract that still exists between a Shipper and NGG for Entry capacity bought in an auction before April 2017 (NC TAR application date). Therefore, a RRC should not apply once the capacity is traded. We would, therefore, encourage Ofgem to explore this further with NGG to ensure that Art. 35 is fully complied with in practice.

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?

As described above, our preference is for 0678 rather than 0678A, which was our stated position during the UNC consultation phase. The Ofgem and CEPA analysis produced to support the 0678 decision has not changed our view.

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

By Ofgem's acknowledgement, the quantitative analysis suggests a small difference between 0678 and 0678A. Therefore, we believe equal emphasis should be placed on the qualitative assessment. We believe that the risks associated with abandoning both cost-reflectivity in network charging and any form of forward looking locational signal outweigh the small differences in payable prices under the two RPMs.

c) Do you agree it best facilitates the relevant objectives? Please fully justify your response.

No, we disagree with the assessment against competition, for the reasons outlined above.

We are also concerned that the PS RPM presents additional risk to the market of unintended consequences that may need to be unwound in future. For instance, if the PS RPM incentivises connections in parts of the NTS with limited capability, resulting in additional potentially inefficient investment by NGG, we would not want to see urgent proposals being raised, seeking to reinstate locational signals in order to address the issue. This would introduce unwelcome regulatory instability to the market. Ofgem, therefore, needs to be comfortable that the PS RPM is fit for purpose for the foreseeable future.

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;

With the models provided by NGG as part of the 0678 development process (and we assume on an enduring basis), it is easy and straightforward to calculate prices. The forecast accuracy of NGG is, however, yet to be tested.

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. The PS RPM assumes cost-reflectivity is not relevant at all. We would welcome clarity from Ofgem on whether cost-reflectivity is still important to some degree or is considered a redundant concept for GB gas transmission.

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 do not agree. The transition to these new arrangements results, in our view, in an undue cross-subsidy between users located in efficient and inefficient parts of the network, effectively penalising demand located close to sources of supply.

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;

GB is not a transit country and therefore this consideration should not apply.

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

The precise impact is unclear.



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 support an implementation date of no earlier than October 2020. It is important that charges continue to align with the Gas Year, to avoid disruption to trading and supply agreements.

Given the pressing need for an effective shorthaul product and anticipated proposals on greater storage discounts, alongside the standard notice periods for charge changes, we feel that October 2020 is a highly challenging target implementation date. On this basis, Ofgem should give consideration to an October 2021 implementation date for all charging-related proposals, including 0678A. This would align with the RIIO-T2 price control period and may help ensure a smoother transition for market participants and minimise the impact on end consumers.

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?

No, our key concerns have been outlined above.