nationalgrid

CONSULTATION DOCUMENT

Modification Proposals to the Gas Transmission Transportation Charging Methodology

NTS GCM 10:

TO Entry Commodity Rebate Mechanism

23rd October 2007

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1 Executive Summary

This document sets out, for consultation, proposals for amending the Gas Transmission Transportation Charging Methodology (the “Charging Methodology”) in respect of the introduction of a TO Entry Commodity Rebate Mechanism which might be triggered in the event of TO revenue over-recovery. This document is issued by National Grid in its’ role as Gas Transporter Licence holder in respect of the NTS (“National Grid”).

From 1st October 2007 the TO Entry Commodity charge rate has been set at zero as a result of the revenue implied[1] by the 2007 AMSEC auction and forecast revenue from the remaining rolling monthly NTS Entry Capacity (RMSEC) auctions. Actual revenue from the remaining RMSEC auctions and the £13.4M of revenue resulting from the Entry Capacity Trade & Transfer processes, introduced through UNC Modification Proposals 0169, will result in TO Entry over-recovery.

In the event of TO over recovery, the prevailing TO over recovery mechanism leads to a credit being paid to all Users based on their Monthly System Entry Capacity (MSEC) holdings to offset NTS Entry Capacity buy-back costs. NTS Entry Capacity buy-back costs represent a cost to Users via the Entry Capacity Neutrality charge. Revisions to this mechanism to increase its efficiency have been proposed through Charging Proposal NTS GCM 09, however, in the event that buy-back costs are less than the over recovery amount, this mechanism will not redistribute the full over recovery amount.

The TO Entry Commodity charge had been set at 0.0120 p/kWh from 1st April 2007 to 31st September 2007. This rate had been determined from forecast TO allowed revenue less implied revenue from earlier auctions and forecast revenue from the RMSEC and AMSEC auctions within the period and will collect approximately £54M. The forecast revenue from these auctions had been based on historical bidding behaviour however prices paid were significantly higher than anticipated due to a combination of entry baseline capacity changes and the anticipated trade and transfer processes. A non-zero rate had also been applied from the April of a formula year due to industry concerns about price stability; previously a non-zero rate had only been applied in the October to March period.

With hindsight the TO Entry Commodity charge may have been set at a lower rate and hence a rebate to this charge could be used to manage any residual over-recovery should the level of buy-back costs lead to the buy-back offset mechanism not being fully effective.

GCM10: National Grid proposes through this consultation document that:

Trigger

- The TO Entry Commodity rebate mechanism would be triggered if there remained a residual over recovery amount after taking into account any revenue redistributed by the buy back offset mechanism (as described in GCM09)
- The mechanism would be triggered even if the buy back offset mechanism had not been triggered

[1] Revenue from the entry capacity auctions is invoiced after the applicable month.

- The mechanism would be triggered at the end of the formula year based on the outcome of all NTS Entry Capacity auctions that represent a TO revenue stream.

Mechanism

- As specified by GCM09 and subject to a decision by Ofgem, any residual over recovery at the end of the formula year would first be used to offset buy backs costs in those months within the formula period when buy-back costs had occurred and no credit had been paid or where the credit was less than the buy-back cost
- Any residual revenue remaining after this process would be available as a credit to shippers i.e. remaining over recovery amount calculated after taking into account any payments resulting from the buy-back offset mechanism
- Credits would only be paid if the residual over recovery was in excess of £1m (this equates to the minimum TO Entry Commodity price of 0.0001 p/kWh)
- The ratio of the remaining TO over-recovery amount and the TO Entry Commodity Revenue paid (April 07 to September 07 only for the 2007/8 formula year) would be calculated
- The ratio would be capped at 1 i.e. only rebate TO Entry Commodity revenue received
- Rebate of TO Entry Commodity charges paid based on ratio
- Rebate paid in April following formula year i.e. April 2008 invoice for the current formula year

Implementation

It is proposed that these arrangements are implemented to amend the TO Over Recovery Mechanism from 1st March 2008. Implementation of this proposal is not dependent on GCM09.

Example

To date, the implied TO over recovery for 2007/8 is £12.35M with £46.7M having been collected through the TO Entry Commodity charge. A rebate of 26.4% of TO Entry Commodity charges would therefore clear the TO over recovery amount.

Future Proposals

This proposal represents the next step in addressing TO Entry over recovery following on from GCM09. Further proposals would be required to address the scenario where both the buy-back offset mechanism, as proposed to be revised through GCM09, and the TO Entry Commodity Rebate Mechanism, as described in this proposal, were ineffective in managing over-recovery. This would be the case if TO over-recovery, after taking into account the buy-back offset mechanism, was in excess of revenue recovered through the TO Entry Commodity charge. To date the implied TO over recovery is £12.35M with £46.7M having been collected through the TO Entry Commodity charge and hence the proposed mechanism being ineffective is highly unlikely to be the case for the 2007/8 formula year.

The closing date for submission of your responses to this consultation is **Tuesday 20th November 2007.**

2 Introduction

2.1 From 1st October 2007 the TO Entry Commodity charge rate has been set at zero as a result of the revenue implied by the 2007 AMSEC auction and forecast revenue from the remaining rolling monthly NTS Entry Capacity (RMSEC) auctions. Actual revenue from the remaining RMSEC auctions and the £13.4M of revenue resulting from the Entry Capacity Trade & Transfer processes, introduced through UNC Modification Proposals 0169, will result in TO Entry over recovery.

2.2 The prevailing TO over recovery mechanism leads to a credit being paid to all Users based on their Monthly System Entry Capacity (MSEC) holdings to offset NTS Entry Capacity buy-back costs. NTS Entry Capacity buy-back costs represent a cost to Users via the Entry Capacity Neutrality charge. Revisions to this mechanism to increase its efficiency have been proposed through Charging Proposal NTS GCM 09, however, in the event that buy-back costs are less than the over recovery amount, this mechanism will not redistribute the full over recovery amount.

2.3 The TO Entry Commodity charge had been set at 0.0120 p/kWh from 1st April 2007 to 31st September 2007. This rate had been determined from forecast TO allowed revenue less implied revenue from earlier auctions and forecast revenue from the RMSEC and AMSEC auctions within the period and will collect approximately £47M. The forecast revenue from these auctions had been based on historical bidding behaviour however prices paid were significantly higher than anticipated due to a combination of entry baseline capacity changes and the anticipated trade and transfer processes. A non-zero rate had also been applied from the April of a formula year in response to industry concerns about price stability; previously a non-zero rate had only been applied in the October to March period.

3 Background

3.1 Entry and Exit TO revenue are managed separately in that TO charges are set such that 50% of TO allowed revenue, other than that revenue collected through the DN Pensions charge, is collected from Entry and 50% from Exit.

3.2 TO Exit Capacity charges are based on administered prices which are designed to collect all TO Exit allowed revenue. TO Entry Capacity charges are based on pay-as-bid auctions and any under recovery is managed by setting the TO Entry commodity charge.

3.3 The TO Entry Commodity charge cannot currently be used as an over recovery mechanism for Entry over-recovery and hence the TO Entry Commodity price cannot be set to have a negative value. The TO Entry over recovery mechanism is based on paying credits which offset entry capacity buy-back costs.

Prevailing TO Entry Over-recovery Methodology

3.4 The following represents the TO over-recovery mechanism prior to the NTS GCM 09 charging proposal.

3.5 If entry capacity auction implied revenue is anticipated to be more than 10% above the target auction revenue[2], the total excess auction revenue is divided into monthly amounts and is used to ‘fund’ the entry buy-back scheme.

3.6 This is achieved by way of credits (a reduction in entry capacity charges) for each month by the lower of the monthly excess and monthly buy-back cost.

3.7 These credits offset the costs of entry capacity buy-back that are borne by shippers through the capacity neutrality mechanism. The credits would be treated as payments to shippers under the Licence $TORCOM_t$ term.

3.8 Any excess amount (of auction revenue) remaining for any month is carried forward to the next month.

3.9 Any excess amount (of auction revenue) remaining at the end of the formula period would feed into the ‘K’ mechanism. Excess revenue from one formula period results in reduced allowed revenue in the following formula period.

4 Discussion and Issues

Issues Regarding the Prevailing TO Over Recovery Mechanism

4.1 The prevailing TO over recovery mechanism may result in credits being less than both the buy back costs and the revenue over recovery in the period hence the process may be inefficient in redistributing excess revenue. This is largely due to the over recovery amount being divided by the remaining months within the formula period and the fact that credits are only paid against buy-back costs that occurred during or after the month in which over recovery has been identified. Buy-back costs from earlier in the formula year but prior to over-recovery being identified would not be included.

4.2 Charging Proposal NTS GCM 09 addresses these issues by;

- making the full over recovery amount available in the first month, rather than dividing by the number of remaining months,
- making credits in relation to any buy-back costs incurred earlier within the formula year,
- making credits up to the buy-back cost rather than up to the net buy-back cost which equates to the buy-back cost less daily capacity revenue and entry capacity over-run revenue,
- clarifying that the mechanism can be triggered by any NTS Entry Capacity auction that represents a TO revenue stream.

[2] Target Entry Capacity auction revenue is currently 50% of the TO allowed revenue remaining after DN pension charges have been deducted.

4.3 Even if these changes are made to the buy-back offset mechanism, there remains a risk that buy-back costs are less than the over recovery amount and hence the mechanism will not redistribute the full over recovery amount. In this scenario, excess revenue would flow into the 'K' mechanism. Excess revenue from one formula period results in reduced allowed revenue in the following formula period. This may lead to excess revenue collected from Entry Users being effectively redistributed on a fifty-fifty basis between Entry and Exit Users in the following formula period.

TO Entry Commodity Charge

4.4 Proposals have been raised in the past to introduce a negative TO Commodity charge to manage over recovery firstly to compliment the buy-back offset mechanism and secondly as a primary over recovery mechanism but both proposals were vetoed by the Authority. The history of revenue over-recovery mechanisms is outlined in appendix A.

4.5 The difficulty with a negative commodity charge in combination with the buy-back offset mechanism is that both buy-back costs and over recovery revenue must be forecast to set the commodity rate and this is far from a simple or transparent process. This appears to have been the key to the Authority's rejection of previous proposals.

4.6 Even if appropriate forecasting processes could be defined, there remains the scenario that over recovery is triggered at a time that does not allow a negative rate to be set within the formula year given the charge notice requirements within the Licence and the UNC. These issues could largely be addressed by applying the charge retrospectively.

4.7 The TO Entry Commodity charge has been set at a non-zero rate for the period April 2007 to September 2007. National Grid recognise that the risk of TO over-recovery might be mitigated by setting a zero rate TO Commodity charge for the first six months of the formula period and hence will consider a return to charging for the winter period only.

TO Entry Commodity Charge Rebate

4.8 The TO Entry Commodity charge had been set at 0.0120 p/kWh from 1st April 2007 to 30th September 2007. This rate had been determined from forecast TO allowed revenue less implied revenue from earlier auctions and forecast revenue from the RMSEC and AMSEC auctions within the period and will collect approximately £47M.

4.9 With hindsight the TO Entry Commodity charge may have been set at a lower rate and hence a rebate to this charge could be used to manage any residual over-recovery should the level of buy-back costs lead to the buy-back offset mechanism not being fully effective in managing any over recovery.

Mechanism Trigger

4.10 The entry capacity buy-back offset mechanism is not triggered until over recovery is in excess of 10% of allowed revenue. NTS GCM 09 would revise this such that the mechanism were triggered if over recover would otherwise be more than 4% in the formula year or more than 6% over the current and previous formula years.

4.11 The trigger for the GCM09 buy-back offset mechanism exists largely to stop both the buy-back offset mechanism and a non-zero TO Entry Commodity charge applying simultaneously. Such a trigger would not be required for any retrospective TO Entry Commodity charge rebate.

4.12 A rebate of TO Entry Commodity charges would represent retrospectively resetting the TO Entry Commodity rate to a lower level. Credits might only be paid if the residual over-recovery was in excess of £1M as this equates to the minimum TO Entry Commodity price of 0.0001 p/kWh i.e. an aggregate credit of £1M would represent a 0.0001 p/kWh reduction to the TO Entry Commodity rate.

4.13 The rebate process could be triggered at the end of the formula year based on the outcome of all auctions representing a TO revenue stream, TO Entry commodity revenue and any credits paid as a result of the buy-back offset mechanism. Revenue from daily auctions would continue to be treated as SO revenue.

Example

4.14 To date, the implied TO over recovery for 2007/8 is £12.35M with £46.7M having been collected through the TO Entry Commodity charge. A rebate of 26.4% of TO Entry Commodity charges would therefore clear the TO over recovery amount.

Future Proposals

4.15 The introduction of a TO Entry Commodity rebate would represents the next step in addressing TO Entry over recovery following on from GCM09. Further proposals would be required to address the scenario were both the buy-back offset mechanism, as proposed to be revised through GCM09, and a TO Entry Commodity Rebate Mechanism, ineffective in managing TO over-recovery. This would occur if the level of over-recovery, after taking into account buy-back offset credits, was in excess of TO Entry Commodity revenue. To date the implied TO Exit over recovery is £12.35M with £46.7M having been collected through the TO Entry Commodity charge and hence the proposed mechanism being ineffective is highly unlikely to be the case for the 2007/8 formula year.

4.16 The next step in addressing TO Entry over recovery could be achieved by applying a negative TO Entry Commodity charge retrospectively across the formula year.

5 National Grid's Proposal

5.1 National Grid proposes that:

Trigger

- The TO Entry Commodity rebate mechanism would be triggered if there remained residual over recovery amount after taking into account any revenue redistributed by the buy back offset mechanism
- The process would be triggered at the end of the formula year based on the outcome of all NTS Entry Capacity auctions that represent a TO revenue stream.

Mechanism

- As specified by GCM09 and subject to a decision by Ofgem, any residual over recovery at the end of the formula year would first be used to offset buy backs costs in those months within the formula period when buy-back costs had occurred and no credit had been paid or where the credit was less than the buy-back cost
- Any residual over recovery revenue, taking into account any payments resulting from the buy-back offset process, would be available as a rebate to shippers
- Credits would only be paid if the residual over-recovery was in excess of £1M (this equates to the minimum TO Entry Commodity price of 0.0001 p/kWh)
- The ratio of the remaining TO over-recovery amount and the TO Entry Commodity Revenue paid (April 07 to September 07 for the 2007/8 formula year) would be calculated
- The ratio would be capped at 1 i.e. only rebate TO Entry Commodity revenue received
- Rebate of TO Entry Commodity charges paid based on ratio
- Rebate paid via April invoice following formula year i.e. April 2008 invoice for the current formula year

Implementation

It is proposed that these arrangements are implemented to add to the TO Over Recovery Mechanism from 1st March 2008. Implementation of this proposal is not dependent on GCM09.

6 Justification

Assessment against Licence Objectives

6.1 The National Grid plc Gas Transporter Licence in respect of the NTS requires that proposed changes to the Charging Methodology shall achieve the relevant methodology objectives.

6.2 Where transportation prices are not established through an auction, prices calculated in accordance with the methodology should:

- 1) Reflect the costs incurred by the licensee in its transportation business;
- 2) So far as is consistent with (1) properly take account of developments in the transportation business;
- 3) So far as is consistent with (1) and (2) facilitate effective competition between gas shippers and between gas suppliers.

6.3 National Grid believes that GCM10 would satisfy the relevant objectives as, in improving the efficiency of the TO Entry Commodity process, the likelihood of over recovery is reduced and hence the aggregate charges would more closely reflect the costs incurred within the formula year.

6.4 The proposal modifies the TO Over-recovery mechanism to take into account past and potential future changes to the NTS Entry Capacity regime and hence "takes into account developments in the transportation business".

Assessment against EU Gas Regulations

6.5 EC Regulation 1775/2005 on conditions for access to the natural gas transmission networks (binding from 1 July 2006) states that the principles for network access tariffs or the methodologies used to calculate them shall:

- Be transparent
- Take into account the need for system integrity and its improvement
- Reflect actual costs incurred for an efficient and structurally comparable network operator
- Be applied in a non-discriminatory manner
- Facilitate efficient gas trade and competition
- Avoid cross-subsidies between network users
- Provide incentives for investment and maintaining or creating interoperability for transmission networks
- Not restrict market liquidity
- Not distort trade across borders of different transmission systems.

6.6 National Grid believes that GCM10 is consistent with the principles listed above, specifically the amended methodology should;

- Be transparent
- Reflect actual costs incurred for an efficient and structurally comparable network operator
- Be applied in a non-discriminatory manner
- Avoid cross-subsidies between network users
- Not restrict market liquidity
- Not distort trade across borders of different transmission systems.

7 Questions for Consultation

7.1 National Grid invites views on whether the proposed changes to our Gas Transmission Transportation Charging Methodology meet National Grid Gas's relevant GT Licence objectives, specifically that:

GCM10: National Grid proposes through this consultation document that:

Trigger

- The TO Entry Commodity rebate mechanism would be triggered if there remained a residual over recovery amount after taking into account any revenue redistributed by the buy back offset mechanism
- The process would be triggered at the end of the formula year based on the outcome of all NTS Entry Capacity auctions that represent a TO revenue stream.
- Credits would only be paid if the residual over-recovery was in excess of £1m (this equates to the minimum TO Entry Commodity price of 0.0001 p/kWh)

Mechanism

- Any residual revenue over-recovery amount, calculated after taking into account any payments resulting from the buy-back offset mechanism, would be available as a rebate to shippers
- Credits would only be paid if the residual over-recovery was in excess of £1m (this equates to the minimum TO Entry Commodity price of 0.0001 p/kWh)
- Ratio of remaining over recovery amount and TO Entry Commodity Revenue paid (April 07 to September 07) Calculated, capped at 1 i.e. only rebate TO Entry Commodity revenue received
- Rebate of TO Entry Commodity charges paid, based on ratio, in April following formula year i.e. April 2008 invoice for the current formula year

Implementation

- These arrangements are implemented to add to the TO Over Recovery Mechanism from 1st March 2008.

Additional Discussion Questions

Views are invited on the following questions.

- Should the TO Commodity Charge be set to zero between April and September of each formula year?
- Should National Grid consider raising a separate proposal to introduce a symmetrical methodology i.e. to have a final payment to manage either over or under recovery?

The closing date for submission of your responses is **Tuesday 20th November 2007**. Your response should be e-mailed to:

box.transmissioncapacityandcharging@uk.ngrid.com

or alternatively sent by post to

Eddie Blackburn, Regulatory Frameworks, National Grid, National Grid House, Gallows Hill, Warwick, CV34 6DA.

If you wish to discuss any matter relating to this charge methodology consultation then please call Eddie Blackburn☎ 01926 656022 or Debra Hawkin☎ 01926 656317.

Responses to this consultation will be incorporated within National Grid's conclusion report. If you wish your response to be treated as confidential then please mark it clearly to that effect.

Appendix A – History of TO Over/Under Recovery NTS Charging Methodology Proposals

The following table outlines the history of the development of the TO over and under recovery mechanisms. The table gives the relevant Pricing Consultation paper number and title along with a brief summary of the proposal and the Authority decision.

Number	Title	Proposal	Decision
PC65	Alternative Methods of Funding Entry Capacity Constraint Management	If auction implied revenue is more than 10% above the target TO allowable revenue, this excess is divided into monthly amounts and is used to pay a credit which offsets the capacity neutrality entry capacity buy-back costs	**Not vetoed**
PC66	Transportation Charge adjustment following Entry Capacity Auctions	Any under recovery would be accounted for through the generality of transportation charges rather than just the NTS Commodity charge	**Not vetoed**
PC67	Technical Adjustment to PC65 Mechanism	Technical adjustment that allowed the credit to be greater than the entry charges paid by an individual shipper	**Not vetoed**
PC75	NTS TO Commodity Charge	Introduction of an NTS TO Commodity charge (that may be negative) to supersede PC65 (compliment PC65 in final proposal)	**Vetoed**
PD17	Setting of NTS Transportation Charges	Consideration of whether the charging methodology is consistent with auction uncertainty	N/A
PC77	NTS TO Commodity Charge	Introduction of an NTS TO Commodity charge (that may be negative) as the primary over/under recovery mechanism with PC65/67 as the secondary mechanism	**Vetoed**
PC78	NTS TO Commodity Charge (NTS TO Under Recovery)	Introduction of an NTS TO commodity charge as a mechanism for dealing with the under recovery of NTS TO revenue only.	**Not vetoed**
GCM09	TO Over Recovery Mechanism	Revise the buy-back offset mechanism to; ○ make the full over recovery amount available in the first month ○ make retrospective credits in relation to any buy-back costs incurred earlier within the formula year, ○ make credits up to the buy-back cost rather than up to the net buy-back cost, ○ clarify that the mechanism can be triggered by any NTS Entry Capacity auction that represents a TO revenue	**Proposal with Ofgem**