Modification proposal:	**Modification Proposal NTS GCM 10 'TO Entry Commodity Rebate Mechanism'**		
Decision:	**The Authority[1] has decided not to veto this proposal[2]**		
Target audience:	**NGG and other interested parties**		
Date of publication:	**8 February 2008**	Implementation Date:	**1 March 2008**

Background to the modification proposal

National Grid Gas (NGG) recovers its Transportation Owner (TO) allowed revenue (other than revenue collected through the Distribution Network pensions charge) through exit and entry charges based on a 50/50 split. Entry capacity charges are recovered from sales of entry capacity through a series of capacity auctions. However, if the revenue through these auctions is projected to fall short of 50% of TO allowed revenue, the shortfall is recovered through TO Entry Commodity Charges, which are estimated and levied by NGG. If revenue recovery is in excess of 50% of TO allowed revenue there is mechanism to offset the over-recovery against any entry capacity buy-back costs that NGG incurs. However, in the event that NGG's entry capacity buy-back costs are less than any over-recovery amount, the mechanism will not fully redistribute the over-recovery amount. In these circumstances, the remaining surplus is carried forward to the following year and offset against the total allowed revenue in that year leading to lower entry and exit charges for users.

NGG has proposed GCM 10 as a means of redistributing any residual over-recovery at the end of a formula year to entry shippers following the application of the buy-back offsetting mechanism.

The modification proposal ("the Proposal")

Through modification proposal NTS GCM 10 (TO Entry Commodity Rebate Mechanism) NGG proposes the following changes:

- Any residual over-recovery of revenue (after the application of the buy-back offsetting mechanism) would be credited to entry shippers[3].
- TO Entry Commodity Charges would be rebated to shippers based on the ratio of the residual over-recovery revenue to the total TO Commodity charge (the ratio would be capped at 1 so that the maximum rebate would refund the entire TO Commodity Charge)
- rebates would be paid to shippers in the April immediately following the formula year

NGG proposes that GCM 10 is implemented on 1 March 2008.

[1] The terms 'the Authority', 'Ofgem' and 'we' are used interchangeably in this document. Ofgem is the Office of the Gas and Electricity Markets Authority.
[2] This document also constitutes notice of the reasons for this decision as required by section 38A of the Gas Act 1986.
[3] There is a de minimis threshold of £1m, below which NGG claims the administrative encumbrance of the redistribution outweighs the benefits

Justification of the modification proposal

NGG considers that NTS GCM 10 better achieves the relevant gas transmission transportation charging methodology objectives in that:

- reducing the likelihood of over-recovery results in charges which reflect better costs incurred by the licensee in its transportation business
- the projected over-recovery of revenues is partly as a result of changes in the entry capacity regime, so acting to mitigate the effect takes account of developments in the transportation business
- the targeted redistribution of over-recovered revenues to those parties who contributed to the revenues should facilitate effective competition between gas shippers and between gas suppliers

Responses to NTS GCM 10

NGG consulted on the proposals in October 2007 and received nine responses. Seven respondents supported implementation of GCM 10 and two did not support its implementation.

There was general support for both the principle of rebating the residual over-recovery (after the application of the buy-back offsetting mechanism) to those shippers who had contributed to the TO Commodity Charge which had resulted in the over-recovery. They considered that such a targeted rebate avoided cross-subsidy of exit charges and users (as would happen if the residual was offset against the following year's allowed revenue) and so would facilitate competition between shippers. Some respondents queried whether the *de minimis* threshold could be set at a lower level than the proposed £1m.

Those who opposed the modification considered that it would discriminate against exit users as they do not benefit from the rebate of over-recovery on entry charges but are still exposed to any under-recovery of entry charges. One respondent considered that it discriminated against users whose gas enters the system but uses the NTS Optional Commodity Charge[4] rather than the TO Commodity Charge. The same respondent commented that NGG should be paying interest on the excess revenues and that the modification should take account of this. Finally, a respondent was concerned that if GCM 10 was approved, it would set a precedent for an under-recovery charge to be introduced and such a charge would have a destabilising effect on shipper charges.

The Authority's decision

The Authority has considered the issues raised by the modification proposal and the Conclusions Report dated 11 January 2008. The Authority has considered and taken into account the responses[5] to NGG's consultation. The Authority has concluded that:

1. **Implementation of the modification proposal will better facilitate the achievement of the relevant objectives of the Methodology[6]; and**

[4] The NTS Optional (commonly referred to as short-haul) Commodity Charge reflects the costs of gas transportation from a terminal to a nearby large supply point. Shippers can elect to pay the optional tariff as an alternative to both the entry / exit NTS SO Commodity Charge and the NTS TO Commodity Charge.
[5] NGG modification proposals, modification reports and representations can be viewed on the NGG website at www.nationalgrid.com
[6] As set out in Standard Special Condition A5(5) of NGG's Gas Transportation Licence, see:

2. **deciding not to veto the proposal is consistent with the Authority's principal objective and statutory duties[7].**

Reasons for the Authority's decision

SSC A5(5)(a) save in so far as paragraphs (aa) or (d) apply, that compliance with the charging methodology results in charges which reflect costs incurred by the licensee in its transportation business

GCM 10 would apply where NGG has underestimated auction revenues and has set the TO Commodity Charge at too high a level to recover 50% of allowed revenues from entry charges in aggregate. The TO Commodity Charge was introduced to act as a rebalancing charge to avoid under-recovery of allowed revenues from entry charges as a result of NGG receiving insufficient revenues from entry capacity auctions; this rebalancing was in turn meant to promote longer-term stability in charges and to try to preserve the recovery of 50% of allowed TO revenues from entry charges. In keeping with this stability concept, where NGG has not been able to forecast accurately the level of the TO Commodity Charge, it is appropriate, and should result in more cost reflective charges, if NGG rebates any over-recovery to shippers rather than create further charging instability by carrying the surplus into the following year.

NGG has a licence obligation to try to ensure that in setting charges, its recovered revenue is not in excess of the allowed revenue. The fact that GCM 10 allows NGG to rebate over-recoveries (limited to the aggregate TO Commodity Charge) does not weaken NGG's obligation to forecast likely revenues and try to avoid any under or over recovery. This should allay the concern that NGG could use this mechanism to accrue excess revenues throughout the year and earn interest on them, to the detriment of shippers.

SSC A5(5)(b) that, so far is consistent with sub-paragraph (a), the charging methodology properly takes account of developments in the transportation business

Ofgem agrees with NGG's view that this year's surplus has arisen partly as a result of unanticipated revenues from newly introduced transfer and trade auctions, and so the proposal meets this objective.

Compliance with the charging methodology facilitates effective competition between gas shippers and between gas suppliers - SSC A5(5)(c)

Ofgem thinks that the proposal is consistent with this objective.

Ofgem notes the objections of some parties to the implementation of this modification proposal. Ofgem does not think that the proposal discriminates unduly against exit users. The charging methodology aims to collect allowed revenue equally from entry and exit charges. Ofgem accepts that if either auction revenues are below expectations or NGG incorrectly forecasts the TO Commodity Charge levels, then there will be an under-recovery which would be carried through to the following year's charges. Exit users will then be exposed to 50% of what should be a relatively small under-recovery amount. However, this risk is symmetric as if there is a significant over-recovery then they benefit

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http://epr.ofgem.gov.uk/document_fetch.php?documentid=8783

[7]The Authority's statutory duties are wider than matters which the Panel must take into consideration and are detailed mainly in the Gas Act 1986.

in the same way in subsequent years. Ofgem considers that this is reasonable and will not distort competition.

Decision notice

In accordance with Standard Special Condition A5 of NGG's Gas Transportation Licence, the Authority has decided not to veto modification proposal GCM10: TO Entry Commodity Rebate Mechanism.

Robert Hull
Director, Transmission

Signed on behalf of the Authority and authorised for that purpose.