nationalgrid

CONSULTATION DOCUMENT

Modification Proposals to the Gas Transmission Transportation Charging Methodology

NTS GCM 11:

Retrospective Negative TO Entry Commodity Charge

8th November 2007

Table of Contents

1 Executive Summary

This document sets out for consultation a proposal for amending the Gas Transmission Transportation Charging Methodology (the “Charging Methodology”) in respect of the introduction of a Retrospective Negative TO Entry Commodity Charge. This charge would be used to manage TO entry revenue over-recovery in the event that there was a residual over-recovery amount after any credits from the buy-back offset mechanism and the TO Entry Commodity rebate mechanism (as proposed through GCM10). 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. Revenue from the remaining RMSEC auctions and the £13.4m implied revenue resulting from the Entry Capacity Trade & Transfer processes, introduced through UNC Modification Proposals 0169, will result in TO Entry 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 introduced 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.

As a consequence, National Grid raised Charging Proposal NTS GCM 10, which proposed the introduction of a TO Entry Commodity charge rebate mechanism. The TO Entry Commodity charge had been set at 0.0120 p/kWh from 1st April 2007 to 30th September 2007 and collected approximately £46.7M. GCM10 would therefore allow for up to £46.7m of 2007/8 over-recovery to be redistributed.

This proposal, GCM11, would introduce a retrospective negative TO Entry Commodity charge which would allow over-recovery in excess of that managed through the buy-back offset and GCM10 processes to be re-distributed. This should allow for any TO Entry revenue over-recovery amount to be managed.

If NTS GCM 10 were implemented, there remains a risk that the mechanism would not fully redistribute the residual over-recovery amount. 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 GCM10 mechanism being ineffective is highly unlikely to be the case for the 2007/8 formula year.

The risk of the GCM10 mechanism being vetoed or not being fully effective in future formula years remains and hence this proposal has been raised at this time.

GCM11: National Grid proposes through this consultation document that:

Trigger

- The Retrospective Negative TO Entry Commodity charge (credit) would be used if there remained a residual over-recovery amount after taking into account any revenue redistributed via the Entry Capacity buy-back offset TO over-recovery mechanism (as revised through GCM09) and the TO Entry Commodity Rebate Mechanism (as described in GCM10)
    - The TO Entry Commodity rebate (GCM10) mechanism, subject to Ofgem non-veto, 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 (GCM09) or the TO Entry Commodity Rebate Mechanism (GCM10) had not been triggered
- The mechanism would be triggered at the end of the formula year based on the outcome of all NTS Entry Capacity auctions that represented a TO revenue stream.

Mechanism

- Any residual revenue remaining after taking into account credits resulting from the Entry Capacity buy-back offset (GCM09) and the TO Entry Commodity Rebate (GCM10) mechanisms would be available as a credit to shippers.
- Credits would only be paid based on relevant entry allocations i.e. those allocations that would attract the TO Entry Commodity charge.
- Each Shipper's credit would be calculated as a proportion of the total available credits from the ratio of Shipper relevant entry allocations to total relevant entry allocations over the formula year.
- 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)
- Credits would be capped at the level of the SO Entry Commodity charge level such that the combined impact of SO and TO Entry Commodity charges did not represent a credit to Shippers.
- Credits would be paid following the end of the formula year based on relevant entry allocations i.e. those allocations that would attract the TO Entry Commodity charge

<u>Implementation</u>

It is proposed that these arrangements are implemented with effect for the current formula year and hence from 31st March 2008.

<u>Future Proposals</u>

This proposal represents the final step in addressing TO over-recovery following on from GCM09 and GCM10. National Grid anticipate that further TO Entry over-recovery proposals might only be required should GCM10 or GCM11 be vetoed or in response to further changes to the UNC.

The closing date for submission of your responses to this consultation is **Thursday 6th December 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. The £13.4m revenue implied by 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 introduced 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.

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.

3.3 TO Entry Capacity charges are based on pay-as-bid auctions and any forecast under recovery is managed by setting the TO Entry commodity charge.

3.4 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 £46.7M. 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. The rate applied from 1st April 2007 represents the first time that a non-zero rate has been applied for the first six months of a formula year. This was in response to industry concerns about price stability; previously a non-zero rate had only been applied in the October to March period.

3.5 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 prevailing TO Entry over-recovery mechanism is based on paying credits which offset entry capacity buy-back costs.

4 Discussion and Issues

Issues Regarding the Prevailing TO Over Recovery Mechanism

4.1 The prevailing TO over-recovery mechanism involves the payment of credits to shippers, based on their capacity holdings, which offsets their exposure to entry capacity buy-back costs. Entry capacity buy-back costs represent a cost to shippers via the capacity neutrality arrangements.

4.2 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.

4.3 As a consequence, National Grid raised charging proposal NTS GCM 10 which seeks to address this issue by introducing a TO Entry Commodity charge rebate to manage any residual over-recovery remaining after taking into account any credits paid via the TO over-recovery buy-back offset mechanism.

4.4 Even if NTS GCM 10 were implemented, there remains a risk that the mechanism would not fully redistribute the residual over-recovery amount. 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 GCM10 mechanism being ineffective is highly unlikely to be the case for the 2007/8 formula year.

4.5 The risk of the GCM10 mechanism not being fully effective in future formula years remains and this could be over come by allowing the TO Entry Commodity charge to be negative.

TO Entry Commodity Charge Issues

4.6 Proposals have been raised in the past to introduce a negative TO Entry 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 mechanism charging proposals is outlined in appendix A.

4.7 The difficulty with a negative TO entry commodity charge in combination with the TO entry 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.

4.8 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 commodity rate to be set within the formula year given the charge notice requirements within the Licence and the UNC. These issues could be addressed by applying the charge retrospectively.

Retrospective TO Entry Commodity Charge

4.9 A retrospective negative TO Entry Commodity charge would allow over recovery to be managed without needing to forecast entry revenue or buy-back costs.

4.10 Concerns have been expressed that a negative commodity charge may affect Shipper incentives to flow gas. Shippers are however exposed to the net SO and TO Entry Commodity charge and hence there would be no change in the incentive properties of the net NTS Commodity charge (SO plus TO) if the TO component were to be negative unless this resulted in the net commodity charge being negative.

4.11 Shippers can already calculate the approximate impact on their net entry commodity charge of the cost of any entry capacity they purchase and this would not change should the TO component be negative. Every £1M spent on entry capacity will result in a 0.0001 p/kWh reduction in the TO Entry Commodity charge over a 12 month period. There should therefore be no change in capacity bidding behaviour as a result of this proposal.

Mechanism Trigger

4.12 The prevailing entry capacity buy-back offset mechanism is not triggered until TO over recovery is in excess of 10% of allowed revenue. The NTS GCM 09 proposal has revised this such that the mechanism will be 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.

4.13 The GCM09 trigger for the 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 negative TO Entry Commodity charge.

4.14 The process could operate 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 and the proposed TO Entry Commodity Rebate mechanism (GCM10).

Mechanism

4.15 This proposal would represent retrospectively setting the TO Entry Commodity rate to a negative value. Credits might therefore only be paid if the residual over-recovery was in excess of £1M as this equates to the minimum negative TO Entry Commodity price of -0.0001 p/kWh. This same approach has been proposed in relation to the TO Entry Commodity rebate proposal NTS GCM 10.

4.16 Credits would also be capped at the level of the SO Entry Commodity charge level such that the combined impact of SO and TO Entry Commodity charges did not represent a credit to Shippers.

5 National Grid's Proposal

5.1 National Grid proposes that:

Trigger

- The Retrospective Negative TO Entry Commodity charge would be used if there remained a residual over-recovery amount after taking into account any revenue redistributed via the TO Entry Commodity Rebate Mechanism (as described in GCM10)
  - The TO Entry Commodity rebate (GCM10) 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 (GCM09) or the TO Entry Commodity Rebate Mechanism (GCM10) had not been triggered
- The mechanism would be triggered at the end of the formula year based on the outcome of all NTS Entry Capacity auctions that represented a TO revenue stream.

Mechanism

- Any residual TO entry revenue remaining after taking into account credits resulting from the Entry Capacity buy-back offset (GCM09) and the TO Entry Commodity Rebate (GCM10) mechanisms would be available as a credit to shippers .
  - As specified by GCM09, 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.
  - As specified by GCM10 and subject to a decision by Ofgem, any residual over recovery at the end of the formula year would secondly be used to rebate TO Entry Commodity charges paid within the formula period.
- Credits would only be paid based on relevant entry allocations i.e. those allocations that would attract the TO Entry Commodity charge.
- Each Shipper's credit would be calculated as a proportion of the total available credits from the ratio of Shipper relevant entry allocations to total relevant entry allocations over the formula year.
- 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)
- Credits would be capped at the level of the SO Entry Commodity charge level such that the combined impact of SO and TO Entry Commodity charges did not represent a credit to Shippers.
- Credits would be paid following the end of the formula year based on relevant entry allocations i.e. those allocations that would attract the TO Entry Commodity charge

Implementation

It is proposed that these arrangements are implemented with effect for the current formula year and hence from 31st March 2008. Implementation of this proposal is not dependent on GCM10.

Future Proposals

This proposal represents the final step in addressing TO over recovery following on from GCM09 and GCM10. National Grid anticipate that further proposals might only be required should GCM10 or GCM11 be vetoed or in response to further changes to the UNC.

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 GCM11 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 GCM11 should prevent cross subsidies between entry and exit Users and hence should facilitate effective competition between gas shippers and between gas suppliers.

6.5 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

6.6 EC Regulation 1775/2005 on conditions for access to the natural gas transmission networks (binding from 1 July 2006) are summarised below. 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.

6.7 National Grid believes that GCM11 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:

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 and the proposed TO Entry Commodity Charge Rebate 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

- Any residual TO entry revenue remaining after taking into account credits resulting from the Entry Capacity buy-back offset (GCM09) and the TO Entry Commodity Rebate (GCM10) mechanisms would be available as a credit 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). Views are invited as to the appropriateness of this threshold.
- Credits would be capped at the level of the SO Entry Commodity charge level such that the combined impact of SO and TO Entry Commodity charges did not represent a credit to Shippers.
- Credits would be paid following the end of the formula year based on relevant entry allocations i.e. those allocations that would attract the TO Entry Commodity charge

Implementation

- These arrangements are implemented with effect for the current formula year and hence from 31st March 2008.

The closing date for submission of your responses is **Thursday 6th December 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	**Not vetoed**
GCM10	TO Entry Commodity Rebate	Revise the TO entry over-recovery mechanism by; ○ introducing a TO Entry Commodity Charge rebate mechanism in relation to TO Entry Commodity charges paid earlier in the year	**Ongoing Consultation**