RWE Supply & Trading

Colin Williams
Charging Development Manager
Gas Charging and Capacity Development
National Grid
National Grid House
Warwick Technology Park
Gallows Hill
Warwick
CV34 6DA

Your ref NTS GCD11

Name Charles Ruffell
Phone +44 (0)1793 893983
Mobile +44 (0)7989 493580
E-Mail
charles.ruffell@RWE.com

14th August 2015

Dear Colin

NTS GCD11: Updating the Cost Inputs to the NTS Optional Commodity Charge Function July 2015

We welcome the opportunity to respond to this Charging Discussion Document. The comments are provided on behalf of RWE companies operating in the UK.

We recognise the analysis that NGG has undertaken in looking to update the NTS Optional NTS Commodity Charge (shorthaul) function. However, we do not believe that either of the proposed options should be implemented. Our principal reasons are that:

- Updating the underlying costs in the charging function while not considering any other parameters has materially reduced the validity of the charges it produces. Other parameters need to be reviewed and the effect of any revised assumptions better understood;
- Updating the charging function as proposed may be inconsistent with the implicit intent the shorthaul tariff, which was to provide relatively stable charges over investment timescales against which an efficient trade-off against pipeline construction could be made;
- The breadth of the proposed updates is material, constitutes a methodological change and should therefore be considered under UNC rather than the lighter touch charging governance arrangements. In any case, for consistency, the charging function should be included in the UNC with other charges;
- With major changes to the charging framework due in the next 18 to 24 months, it makes more sense to consider shorthaul once there is more certainty, rather than making piecemeal changes in the interim;
- Contracts have already been entered into to secure the NTS Optional Commodity charge based on the current methodology. Changing the methodology and hence the NTS Optional Commodity tariff will have a significant negative impact on the economic value of these contracts.

We do not support making any changes to NTS Optional NTS Commodity Charge function at this time and strongly believe that it is both inappropriate and impractical to introduce new tariffs from April 2016. Our view is that even the superficially simple updates proposed under Options 1 and 2 have wider implications for the structure of the tariff that need to be considered under UNC governance.

Our preferred way forward would be to work with National Grid to develop an enduring product that retains shorthaul principles, is consistent with wider charging arrangements and provides sufficient advance notice for shippers to make the necessary commercial decisions.

If you require any additional information or wish to discuss any aspects further, please do not hesitate to contact me.

Yours sincerely

By email so unsigned

Charles Ruffell
RWE Supply & Trading GmbH, Commercial Asset Optimisation UK

Consultation Questions

Question 1: Do respondents prefer Option One or Option Two as the most reasonable approach, and most consistent with facilitating the relevant objectives, to update the underlying costs of the formula in an effort to bring the NTS Optional Commodity charge formula more up to date?
We do not support implementation of either option.

National Grid's proposed updates are based around ensuring the underlying assumptions in generating the current NTS Optional Commodity charge formula, where possible, remain unchanged and using the same structure in the formula resulting only in updates to the four numerical constants in the equation. This is an over-simplification and we think that the validity of the charging function has been undermined. Introducing only minimal changes has required National Grid to make some more general assumptions in order to calibrate the formula. These include assumptions about the portfolio of pipe sizes, which impact upon not only unit costs but also on the distance / flow rate combinations and both of these drive the tariff rates.

In terms of the relevant objectives:

(1) Reflect the costs incurred by the licensee
It is unclear why National Grid has retained a 10 year annuitisation factor, when 45 years would be more consistent with depreciation of its pipeline assets. Extending the annuitisation factor would reduce charges.
PC9A[1] suggested using RPI-X (with X set at 2%) as one way of adjusting pipeline costs in the formula. This was proposed as a surrogate for efficiency gains in pipeline construction. National Grid operated under the RPI-X form of control until March 2013 and it would be informative to compare results based on RPI-X with those using a steel index and RPI to index costs from 1998 up to 2015/16 as currently proposed. National Grid has produced the current formula simply inflated by RPI for comparison purposes. This has produces tariff rates well below options 1 and 2 and it is not clear why this approach was rejected for further consideration

Finally, we would question whether National Grid's assets are the correct comparator in any case when the majority of recent NTS connections have been constructed by developers rather than National Grid. Our experience is that pipe sizes at the lower end of National Grid's suggested range would be sufficient for typical projects. What is required is a proxy for the cost of the least expensive alternative to developers investing in bypass to provide a strong incentive to avoid using NTS even where sufficient capacity is in place to accommodate them.

(2) Take account of developments in the transportation business
The current shorthaul charge has not been reviewed since 1998 despite other significant developments such as the separation of the TO and SO price controls and replacement of RPI-X with RIIO. We question whether now is the right time to implement changes? Significant developments to the transportation business (including GTCR, EU Tariff Code and implementation of other EU Network Codes) are expected in the next 18 months and our preference is to review shorthaul as part of a more holistic review of charging and avoid multiple changes in a short space of time.

(3) Facilitate effective competition
The proposed changes will have a modest impact on the overall level of Commodity charges paid by all system users but will have disproportionate impact on the costs faced by individual users. In making these changes it is important that the principle behind shorthaul is not lost as the change, coupled with high combined Commodity charges will give strong incentives to bypass the NTS, increasing charges and reducing competition for those connected to the NTS.

---
[1] Transco Pricing Consultation Paper PC9A, Optional NTS Commodity Tariff, November 1997

Question 2: Do you agree with the proposal to delay reviewing the methodology / access and flexibility of the NTS Optional Commodity charge until EU TAR / GTCR is more certain?
We agree that it does not make sense to undertake a fundamental review of the NTS Optional Commodity charge until there is certainty about the EU TAR and Ofgem's GTCR as both could have a significant impact.

Under the current version of the EU TAR (July 2015) shorthaul tariffs would be set by applying a discount to the capacity reserve price. This contrasts with the current shorthaul tariff that is commodity based.

To address its concerns about aspects of the current GB charging arrangements, Ofgem has, inter alia, proposed introducing fully-floating capacity charges for long-term capacity products under GTCR. Under the fully-floating capacity charging arrangements, the commodity charge would be set to recover only actual flow-based costs.

Question 3: Do respondents agree with our proposed approach on timescales for notifying a change to NTS Optional Commodity charges, following the same notice periods as for other NTS charges? If not what do you believe these should be?
No, we do not agree. In our view, the tariff should be fixed at the time of election. However, where changes are made, any notice period should reflect the nature of shorthaul as a proxy for the alternative cost of building a dedicated pipeline and be at least 18 months.

Question 4: Do respondents believe 1 April 2016 is an appropriate implementation date? If not what do you believe the implementation date should be and why?
No. The changes are much wider than simply an update to the relevant input costs. We believe that the proposed changes result in changes to the methodology which would require a UNC modification. An example is the 0km (connection cost) element. In the original charge function, separate connection and pipeline costs were identified in National Grid's price control. These are not now available so, in the updated charge function, this is proposed to be based on 14.55% of the project cost at 50km distance for the different flow rates, and indexed 09/10 costs to 2015/16 prices using RPI. A fuller exploration and understanding of the ongoing relevance of including a connection cost element in the formula, alongside a consideration of options to implement it is required. We have already noted our concerns with the assumptions about the relevant pipe size portfolio assumed in the formulae.

Our view is that a UNC modification is required to implement any changes to the charge function and that typical UNC development timescales coupled with subsequent notification of any changes to charges is inconsistent with an April 2016 implementation date. As there is expected to be more clarity around the TAR NC and GTCR during 2016, our preference would be to review shorthaul in the context of any revised charging framework. This would allow shippers to take a more informed decision about electing for shorthaul, which is essentially a long-term trade-off against investment.

From a practical perspective, counterparties have already entered into contracts to secure the NTS Optional Commodity change based on the current methodology. If the methodology changes prior to the expiry of these contracts then it is likely that the will be a significant impact on the economic value of these contracts.

Question 5: Are there any elements that you feel we should take into consideration, or that you believe we have missed and should take into account, in the two options being considered for reviewing the NTS Optional Commodity Charge?
There are a number of issues that we believe should be considered:

- Further explanation of the inclusion of connection costs in the methodology as they are funded outside of transportation charges;
- Derivation of the 0km element;
- A more appropriate annuitisation factor;