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To Gas Charging Team

NTS GCD11 – Updating the Cost Inputs to the NTS Optional Commodity Charge Function

VPI Immingham welcomes the opportunity to respond to the above discussion document. VPI Immingham is a combined heat and power (CHP) plant near Immingham, on the south bank of the river Humber. It is one of the largest CHP plants in Europe, capable of generating 1240MW – about 2.5% of UK electricity peak demand and up to 930 tonnes of steam per hour, which is used by the nearby Humber and Lindsey oil refineries to help turn crude oil into products. As a result, the power station is dependent on the oil refineries and vice versa so any changes to production at the refineries, as recently announced by Total regarding Lindsey oil refinery, are likely to also impact VPI Immingham.

As an organisation, we support the principle of the Optional Commodity Charge ("shorthaul") function and believe that it should be applied specifically to incentivise use of the NTS over a private pipeline for large users of gas close to an entry point. Costs should also reflect the actual cost of laying and operating a separate pipe. With plant currently up to 100km away from entry points making use of the Optional Commodity Charge Function and given that the analysis contained within the discussion document suggests that few parties are expected to swap over to the Commodity charges following this change, we would question whether, even following the increase to the costs, the tariff is achieving its objective. This outcome is contrary to the original principles of the Optional Commodity Charge

The primary justification for the review of shorthaul has been the growing impact on the wider community, i.e. the growing under-recovery of revenue from shorthauling sites, which is due, primarily, to the fact that shippers are using shorthaul over ever-increasing distances. This is highlighted by National Grid Gas' October 2014 analysis for the NTSCMF workgroups that shows that 50% of the shorthaul benefit is realised by the top 25% of plant furthest from entry points. Certainly, the proposals put forward do not eliminate this anomaly, rather tinkering with the established formula resulting in wider distributional inefficiencies (which manifest in excessive charges for shorter distance, shorthaul volumes to "historical" offtakes).

We would therefore advocate a more rigorous review of the methodology and values, in line with the EU Tariff Network Code, where changes are expected to be implemented in 2017/18 and Ofgem's Gas Transmission Charging review. This would result in the more appropriate uptake of the tariff, i.e. by shippers near an entry point who could benefit from installing and operating their own pipeline, and would resolve the issue of increasing commodity charges. At the same time as a rigorous review, inputs and costs could be reviewed to ensure that they are appropriate. We do not think that purely inflating existing costs in an arbitrary manner is the right approach.

We have serious reservations regarding the approach to this change with National Grid having the ability to make the changes based on opaque data with no formal governance in place.

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Both the lack of transparency regarding how the formula is derived and the fact that National Grid can make the change without any formal consultation is concerning. In addition, the decision to use the Optional Commodity Charge function is based on a one off decision whether to build your own pipeline or to use the NTS. Therefore, it does not seem appropriate that shippers are exposed to the cost of building a new pipeline today, when the decision, in VPI Immingham's case, was made over 10 years ago on the basis of the costs at the time. Furthermore, we do not understand the relevance of using the RIIO-GT1 costs for shorthaul tariffs as they are forward looking allowances with no historical link and suitable for the NTS, not installing and operating a "bypass" pipeline. National Grid must provide further justification for their use instead of a pure RPI approach.

Our response to the questions posed is outlined below, but we do not support the proposed changes at this time nor the proposed timeframes, believing them to be lacking in transparency, robustness, too short timescales and falling in the middle of a gas year. With many gas power generators currently struggling and most not turning a profit, significant changes to cost bases with little notice period can further exacerbate the problem. This could lead to further plant closures so the impact should be reviewed in the context of the wider electricity security of supply.

By permitting longhaul offtakers to continue to benefit from the shorthaul tariff, at the expense of all other users, those disadvantaged are effectively cross subsidising others. The key component of the formula to calculate the tariff is the peak day demand. It is not clear why this is pivotal in determining whether to use shorthaul as distance is a far bigger drive of the cost of a bypass pipe. Therefore, we believe that the review should include a more robust review of the tariff and the inputs into the formula.

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 think it appropriate that either of these two options should be implemented. There is a lack of transparency regarding how the formula and the constants are calculated that we believe needs further review. We also are unsure as to why the RPI only approach has been discounted and no rationale has been provided for this, with only the two options with the biggest financial impact being proposed. The RPI only approach would appear to the most reasonable as it applies to the costs established at the time that shorthaul was applied, as opposed to the forward looking RIIO-GT1 costs that have no historical link.
    - Should the decision to make the change go ahead, we prefer Option Two. We think that it is more appropriate to retain the existing pipe sizes and inflate them to 2015 prices plus include the pipe sizes as included under RIIO-GT1 price control period. Users may be using previous pipe sizes and it is right that these continue to be used in the formula. Due to the lack of transparency, at the very

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least, confirmation from Ofgem is required as to the validity of the numbers used, as suggested by National Grid.

- In addition, we are unsure why National Grid would look to use the same size pipe sizes as under RIIO-GT1. These are pipe diameters that would be used in the gas transmission system. However, the premise of the shorthaul tariff would be to reflect the construction of a pipe that would bypass the NTS and therefore be considerably smaller. In addition, the size of the offtake is of far less relevance than the distance from the entry point when considering a bypass and we believe that the relative weightings given to distance and size require a review.

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 with the proposal to delay reviewing the methodology / access and flexibility of the charge until any changes that are required as a result of the EU Tariff Network Code and Gas Transmission Charging Review are understood.
    - With this expected to in 2017/18, we would suggest not making any changes until outcomes of the full review can be implemented. Under the current proposal, there would be a significant increase in our costs in 2016, with further wholesale change likely the following year which adds further uncertainty to power generators' cost base going forward. This would also ensure the suitability of the shorthaul tariff for those plants that genuinely could benefit from bypassing the NTS.

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?**

    - Yes, we agree that all notification should be aligned. However, notification periods are too short and we believe that a longer notification period is required. The proposals constitute a significant change, as demonstrated by the additional c.£30m collected under both Option One and Option Two. Therefore, we believe that a longer notification period is required to allow for the fact that budgets may already be set for the next calendar year and in the context of many gas power plants suffering serious financial hardship.
    - Changes of this nature on the electricity side have a significant notification period allowing parties to factor changes to their cost base into their forward looking plans. This is particularly important given the forward looking nature of the power market (in that it is trading two years ahead and capacity mechanism bids are made 4 years ahead).

4. **Do respondents believe 1st April 2016 is an appropriate implementation date? If not, what do you believe the implementation date should be and why?**

    - No, we do not believe that April 2016 is a suitable implementation date. With this likely to be less than 6 months from the date of any decision being

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published and likely to result in significant increases to costs for some gas shippers, when budgets may already be set, timeframes appear to be too short.

- In addition, April falls in the middle of the gas year and the changes may require changes to contracts mid-year that may not be possible. It is not in the interests of the market to make significant price changes mid-year. At the very least, implementation should be from October 2016, but we would prefer this to be longer.
- With further change expected in 2017/18, we think that all changes should be aligned and implemented at the same time to provide certainty to shippers.

5. Are there any elements that you feel we should take into consideration, or that you believe we have missed should take into account, in the two options being considered for reviewing the NTS Optional Commodity Charge?

- As outlined previously, we would like to note that the proposed solutions do not achieve the proposed objective of the review, namely that some shippers are benefitting from the shorthaul tariff at a cost to all other users and therefore the proposed solution, that penalises all shorthaul users of any distance, is inconsistent with the proposed objective and fails to remedy the issue. We would advocate a more robust review of the interaction between pipe size and distance from the entry point, with more emphasis applied to distance as this is of more relevance.
- Another option would be that shippers currently using shorthaul remain on the same tariff, with new shippers exposed to an updated formula. This is because the investment decisions were made on the basis of the costs at the time and not on the basis of today's costs.
- Given the substantial increase in costs likely to be incurred by many of those parties on the "shorthaul" tariff today, we wonder whether a phased approach could be introduced, whereby the additional costs are introduced over a two year period. Increases to costs of this order of magnitude could cause further financial hardship for plant that are already struggling to break even.

We would be happy to further discuss any of the points raised in our response to the consultation. For further information, please contact:

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