

National Grid Charging Discussion Document: GCD11 – Updating the cost inputs to the NTS optional commodity charge function

Consultation Response

Energy UK is the trade association for the energy industry. We represent over 80 members made up of generators and gas and electricity suppliers of all kinds and sizes as well as other businesses operating in the energy industry. Together our members generate more than 90 per cent of the UK's total electricity output, supplying more than 26 million homes and investing in 2012 more than £11 billion in the British economy.

Energy UK welcomes the opportunity to provide comments to this discussion document, we have been actively involved in the charging meetings where this has been discussed. However we have particular concerns with the process being followed by National Grid, most especially with regard to transparency of data and methodologies and the absence of a proper governance process involving Ofgem for changes to charges which may have a material impact on customers.

Governance

There seems to be no governance around this proposal to change the cost inputs to the optional commodity charge (OCC) function. It is not clear why the OCC function and methodology for determining the cost inputs was not included in the UNC at the time of the first stage of the code governance review (CGR). UNC modification 322V¹ makes no mention of the OCC function being consciously excluded, we can only conclude that this was an oversight. Therefore in order to fully implement the principles of CGR **we consider the OCC charge function and methodology for determining the indices should be included in the UNC before any changes are introduced.** This would provide for full discussion of the determination of indices under UNC governance arrangements and would allow market participants the opportunity to raise alternative proposals.

In addition National Grid maintains that a UNC modification is not necessary to update the cost inputs, but given the options presented in the document it seems that the methodology is different to that used back in 1998 when the OCC function was established. Such a **change in methodology should be subject to proper governance, full consultation and Ofgem decision.**

Transparency

The methodology for determining the indices in 1998 does not seem to be publicly available, so it is not possible to judge to what extent the methodology is changing. But the fact that two options are presented suggests some change to the methodology. **The methodology and data used to determine the indices in 1998 should be published.** In addition **the original pricing consultation papers PC9, PC9A, the consultation report and Ofgas's decision letter should also be published.** (The current archive on National Grid's website only goes back to GCM01 in 2006).

¹ <http://www.gasgovernance.co.uk/CGR>

The discussion document describes a number of options for indexing costs but does not then describe how this cost information is translated into indices within the charge function. **National Grid should publish the methodology for the determination of the indices.**

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?

Given the information provided it is not possible to express a preference as to which option is most consistent with facilitating the relevant objectives. It is not clear why a simple RPI indexation has been rejected. No justification is provided for increasing charges above RPI as both option one and two appear to do. This seems particularly relevant since for most of the period from 1998, National Grid was subject to RPI-X regulation. The original consultation document PC9A did not consider that the price for a particular site would need to be recalculated once established, but the consultation report introduced revision to the charge by RPI-X (with X being 2), however this was not consulted upon and appears to have been rejected by Ofgas.

It is our understanding that the OCC function was originally supposed to replicate the cost of building a by-pass pipeline, publication of the original papers is needed to clarify this. However if this is the case option one seems to be flawed as it only uses the allowances for pipe sizes where National Grid has agreed these with Ofgem, which may bear no relation to the actual or historical costs of building a pipeline so have not been demonstrated to be cost reflective. In addition these pipeline sizes are far larger than those which would be needed to build a pipeline for NTS bypass for a gas-fired power station or industrial site, so do not seem appropriate or cost reflective for the vast majority of sites using the optional commodity charge function. A 600mm pipe would be sufficient to provide a flow of 12 mcm/d² which is more than required for a 2GWe CCGT generation plant, the largest currently proposed. Therefore increasing the flow rate range also needs further analysis and justification, furthermore we consider this to be a change in methodology so should be subject to full governance under the UNC.

Option one uses RIIO-T1 unit costs and then indexes by RPI. However it is not self-evident that these costs or indexation are cost reflective, no evidence is provided. More work needs to be done to justify this, perhaps benchmarking against actual costs. For example a developer building a new gas-fired power station would generally build its own connecting pipeline to the NTS as it is generally cheaper to do so than for National Grid to provide this.

Option two uses a mixture of a steel index and RPI, why not the steel index for the whole period? This may be more cost reflective if materials are the key cost driver. It would be useful to understand how much of a pipeline cost is materials and how much is other costs such as labour. This may then allow a more appropriate cost reflective indexation arrangement to be considered.

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?

Yes – but we consider the whole issue should be reviewed under UNC governance by incorporating the charge function and methodology for determining the indices into the UNC.

It also seems likely that a further review of the OCC will be necessary when the TAR code is implemented so it would seem more sensible to review this in a holistic manner at that time rather than making iterative changes which have a material impact on certain customers' charges at this time.

² <http://www2.nationalgrid.com/UK/Services/Gas-transmission-connections/Capacity-and-connections/Processes/Parca/> 31 Jan 2013 meeting

This may address the current concern over the number of sites / volume eligible for the shorthaul tariff, since the TAR code places greater emphasis on cost recovery via capacity charges than commodity charges. The latest draft TAR Code, recognises shorthaul but anticipates it being a discount from the capacity reserve price³.

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?

Yes the notification periods are consistent with other charges. But the changes to the methodology for determining the cost inputs and indices, we believe should be considered under UNC governance.

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?

Our Members have a range of views on this issue ranging from April 2016 to aligning with changes arising from the EU tariff code / Ofgem transmission charging review so that a more holistic approach can be taken. There is support for any change to take effect from October rather than April to align with the contract year.

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 elements that we consider need further attention:

- The impact on customers
- The impact on market efficiency
- Potential impact on electricity security of supply, if the economic viability of marginal CCGTs, currently on the shorthaul tariffs is affected, mothball / closure decisions may be brought forward.
- Impact on long term investments both past and future, the decision to build / or not to build an alternative pipeline is a one-off at a point in time. Consideration should be given to the OCC reflecting that decision.
- Whether the revised tariff should apply only to new points applying for the shorthaul tariff.
- Clearer definition and transparency of the methodology to determine the indices especially since paragraph 5.9 of the discussion document seems to suggest regular updates.
- Updating by RPI needs further consideration as to whether that is cost – reflective of material and labour costs. Other indices may be more appropriate.
- Further exploration of the impact of the change to the flow rate assumptions
- Establishment of better governance by including the formula and methodology for determining the indices in the UNC

Energy UK would be happy to discuss these points further, in the first instance please contact Julie Cox, details below.

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Contact:
Julie Cox
Head of Gas Trading

³ <http://www.entsog.eu/publications/tariffs#TAR-NC-RE-SUBMITTED-TO-ACER>

Energy UK
Charles House
5-11 Regent Street
London
SW1Y 4LR
Tel: 020 7930 9390
julie.cox@energy-uk.org.uk