

CONCLUSIONS REPORT TO THE AUTHORITY

**Modification Proposals to the Gas Transmission
Transportation Charging Methodology**

NTS GCM 03 :

**Introduction of an SO Commodity Charge for NTS
Storage Facilities**

20 December 2006

Version for Publication

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1. National Grid's Initial Proposals

On 20th October 2006, National Grid NTS commenced a 28 day consultation on a proposed amendment to the Gas Transmission Transportation Charging Methodology (the "Charging Methodology") in regard to the application of an SO Commodity Charge on Users at NTS Storage Facilities. Specifically, National Grid NTS proposed that :

- an SO Commodity Rate is applied to all NTS storage input and output gas flow allocations (the "Storage SO Commodity Rate") at a lower rate than currently applicable for all entry and exit gas flow allocations (the "Standard SO Commodity Rate");
- the Storage SO Commodity Rate is determined by excluding relevant SO costs in respect of compressor gas and Operating Margins (which are included in the Standard Commodity Rate) as they are not considered to be driven by the operation and ongoing support of NTS storage facilities and would hence minimise the potential for double charging;
- any adjustment in charges arising from the outcome of the SO incentives schemes remains with the Standard SO Commodity Rate, consistent with its purpose of ensuring National Grid NTS recovers its SO allowable revenue, and to ensure the forward-looking cost-reflective approach of the proposed Storage SO Commodity Rate is maintained; and
- the new Storage SO Commodity Rate is implemented from 1 April 2007.

The proposal, if implemented, would not change:

- the target level of revenue to be recovered through NTS SO Commodity Charges¹; and
- the current charging arrangement in respect of storage own-use-gas quantities which attract the Standard SO Commodity Rate.

¹ The Standard SO commodity rate, the proposed SO storage commodity rate, the NTS Optional commodity rate, & the St Fergus compression charge

2. Summary of Responses

	Respondent	Short Code	View
Shippers	British Gas Trading	BGT	Not in support
	Centrica Storage	CS	Not in support
	EDF Energy	EDF	Not in support
	EDF Trading	EDFT	Not in support
	EON UK	EON	Not in support
	RWE npower	RWE	Conditional Support
	Scottish and Southern	SSE	Conditional Support
	Statoil (UK)	Stat	Not in support
	Confidential Respondent 'A'	'A'	Not in support
	Confidential Respondent 'B'	'B'	Not in support
User Associations	AEP	AEP	Not in support
	Gas Storage Operators Group	GSOG	Not in support

3. Consultation Responses

a) General

Respondents' Views

National Grid NTS received 12 responses to its consultation on NTS GCM 03. Two of the responses were marked as confidential. Copies of the non-confidential responses have been posted on the Gas Charging section of the National Grid information website.

Many respondents acknowledge the fact that the introduction of an SO commodity charge at storage sites is not a new issue and recognise that this follows previous rejections of Network Code Modification Proposals (0532, 0544, & 0547) and Ofgem's

suggestion that a more cost-reflective charge is developed. AEP notes that the “*Network Code and charging methodology have been out of alignment since PC73 was not vetoed in 2002*”, and accept in principle that “*some kind of charge is better than no charge at all at storage connection points*”

However, a number of respondents question whether the new charge is sufficiently cost-reflective and suggest that it introduces discriminatory arrangements between storage connection points and other offtake points. Many suggest that any storage commodity charge should be levied on gas that is actually offtaken, rather than on commercial flows as proposed.

Of those respondents not in support of the proposal, six (BGT,CS,EDF,'A',Stat, 'B') express concern on the potential impact on the storage business and the extent of storage cycling through the year. Four respondents (EDF,GSOG,SSE,Stat) argue that the charging proposal that has been put forward overlooks the benefits that NTS storage provides to the NTS.

Of the two respondents who express conditional support for the proposals, their support is subject to a number of changes to the proposed methodology, such as an amendment to the under/over-recovery mechanism, which cost elements should be included, and a suggested approach towards forecasting storage flows. These are discussed in more detail in Section 3 (c & g). RWE states that they continue to support applying an SO commodity charge at storage facilities, provided it is demonstrable that such a charge is cost-reflective.

In its response AEP states “*we accept that some kind of charge is better than no charge at all at storage connection points*” however they suggest that the charge should be based on the same principles as at other offtake points in that it should be levied on gas that is actually offtaken. AEP further suggests that National Grid NTS has ignored a number of other points made by Ofgem in its decision letter, specifically:

- *...any particular benefits provided by storage sites to Transco as system operator should not be factored into the calculation of the SO commodity charge....should be reflected in system management services agreements.'*
- *... shippers flowing gas into storage should not be treated differently to other users of the NTS in bearing a proportion of throughput based charges...*
- *...storage sites are not necessarily unique in the benefits that they provide in terms of system operation.*
- *...users of pumped storage facilities do not benefit from exemptions from NGC's BSUoS charges in the electricity sector.*

AEP observes that any cost-reflective charge should be introduced on the basis of storage users not bearing an unreasonable share of the overheads associated with operating the system. Two respondents (AEP,EDF) also make reference to Ofgem's preference to see a more cost-reflective charge applied to storage than the full SO commodity charge. However, they argue that the regulatory and market environment since Ofgem's decision letter have changed significantly (e.g. GDN sales, new European Legislation) and question whether Ofgem's stated objectives are still applicable.

CS suggests that the increased number of storage facilities have added very little overheads to the costs of operating the system and all incremental costs have been already provided through the entry capacity mechanism. CS also argues that the increase in the number of storage facilities does not change the issues raised in previous Network Code Modifications.

CS comments on the UNC Modification and Pricing Consultation process that needs to be adopted for the introduction of the proposed SO storage commodity charge, suggesting that consultation and implementation of the proposed charge should not take place until following the outcome of the UNC modification process.

National Grid NTS' Response

National Grid NTS welcomes the responses received to its Pricing Consultation Paper and in particular the detailed comments received regarding the proposed methodology. National Grid NTS recognises the concerns that have been expressed and our comments to these points are provided in the relevant sections below.

In coming forward with these proposals, National Grid NTS believes that it has acknowledged the majority of points raised in Ofgem's decision letter, including those referred to by AEP in its response, and these are discussed later in this Consultation Report.

Whilst recognising developments in the regulatory and market environment that have taken place since a proposed SO Commodity Charge for Storage Facilities was first put forward, National Grid NTS considers that its requirements under the UNC and its GT Licence obligations have not substantially changed during this time. National Grid NTS believes its proposals contained in NTS GCM03, incorporating a number of minor revisions to the methodology put forward in this Report, further meet these obligations.

National Grid NTS made reference to the increasing number of storage facilities as part justification for its decision to raise these proposals, rather than in respect of any impact on overheads costs. National Grid NTS also agrees that many of the issues brought to light as part of the previous Network Code Modifications (0532, 0544 & 0547) still exist, and consequently these proposals are intended to address the same issues.

Regarding the points of due process raised by CS, National Grid NTS can confirm that it is required by Standard Special Condition A5 of its GT Licence to initiate a pricing consultation exercise for proposed changes to its charging methodology, and arguably it is at this stage of the process where consideration and consultation of the merits or otherwise of the suggested methodology change should take place. However, where any changes to its charging methodology impact on the UNC, then implementation would also necessitate the consultation and approval of a UNC Modification Proposal.

b) Cost-reflectivity – general

Respondents' Views

A number of respondents (CS,'A',SSE,Stat,BGT) suggest that insufficient transparency and detail have been provided in National Grid NTS' proposed methodology to allow informed judgements to be made about whether the appropriate level of the individual cost elements have been apportioned to the proposed charge. GSOG states that *"The "analysis" produced is purely qualitative in nature which prohibits the reader from ascertaining how the final charge level was arrived at."* Respondent 'A' notes *"that the proposal does not state with sufficient clarity how the proposed Storage Charge will be calculated in a cost-reflective manner."*

Stat argues that it is difficult to make comment on the suitability of the proposals as the state of the regime as of 1 April 2007 is still unknown. It suggests that if Enduring Exit reform is implemented the regime will look very different to now and elements of the proposed charge will no longer be appropriate.

Respondent 'A' further adds that to satisfy the criterion of cost-reflectivity further consultation is required regarding developing charges that are proportionate to different storage sites, and that a standard charge for all storage sites does not satisfy this test. Respondent 'A' suggests that "blanket application" does not meet the requirement in EC Regulation 1775/2005 that "*network access tariffs shall be applied in a non-discriminatory manner*". It also suggests that the document "*has not detailed sufficiently the reasons that the proposed SO Commodity Charge for NTS Storage Facilities is necessary to address National Grid's costs with regard to storage, nor provided an adequate breakdown of the way in which the proposed Charge will be administered.*" Respondent 'A' also questions the cost apportionment being based on throughput, which does not reflect general system costs. It states that "*storage represents only a small fraction of the volume of gas that create costs for the National Grid and that, therefore, this proposed Charge creates a disproportionate liability for storage users which is in breach of the requirements of EC Regulation 1775/2005 that any tariff must "reflect actual costs incurred"*".

CS and EDFT also suggest that the SO costs are not necessarily driven by throughput, with CS suggesting that only a proportion of the Transporter's IT costs should be included, which would suggest a non-throughput based charge, and with EDFT suggesting a fixed daily charge, similar to the CSEP admin charge. CS argues that a charge based on throughput "*would create a disproportionately high charge*" for large storage facilities with the majority of costs relating to IT and administration, and suggest a level charge on a "per connection" basis for each facility.

Six respondents (EDF,GSOG,SSE,Stat,'A',CS) state that they do not believe the proposed charge takes account of the benefits that storage facilities provide to the NTS, by creating transmission capacity and releasing gas onto the system when demand is high. CS suggests that where storage sites contain their own compression and re-deliver gas back to the NTS at higher pressure, this benefit of providing compression to the NTS needs to be deducted from any proposed charge. On a similar point, GSOG argues that in terms of compression, storage provides "invaluable assistance" to the NTS. It states that with storage injection during the summer months a number of entry point flows will be able to move into store without the need for compression (due to the proximity of many storage points to beach entry points) and during periods of withdrawal the need for compression in the NTS is minimised due to the proximity of storage sites to areas of demand. Two respondents (SSE, Stat) suggest that due to these potential benefits that Storage Users should receive payment for services provided to National Grid NTS, or the benefits should be factored in the proposed charge. Respondent 'A' considers whether it is more fitting that such costs should be charged by the storage owner/operator, not National Grid NTS.

CS questions National Grid NTS' view that the proposal would comply with EC Regulation 1775/2005 due to its lack of influence on the actions of storage users, since in CS' view the £5.3m annual charge would have a direct impact on the cost of marginal gas provided from storage facilities. CS states that 77% of the costs would be incurred at Rough, and comments on the short distance of NTS utilised by gas travelling to Rough and thus the benefits through reduced compression needed to transport gas to the rest of the system.

National Grid NTS' response

In developing these proposals, National Grid NTS has considered previous Ofgem decisions in which the proposed application of the full SO Commodity Charge, which is currently levied on all NTS entry and exit flows except storage, was considered to be viewed as double charging. National Grid NTS' proposal therefore seeks to address this issue in a way that maintains the principles in which SO Commodity charges are levied on all Users, but removes elements of the charge calculation that are potentially not appropriate for storage flows.

National Grid NTS notes the concerns expressed that insufficient detail and analysis has been provided within the Consultation Paper. In setting out the Consultation Paper National Grid NTS was keen to ensure that sufficient explanation was provided to allow Industry parties to form views on the principles and suggested approach for the proposed charging methodology set out in NTS GCM03. It should also be noted that an indication of the levels of the different SO cost elements, and the proportion of revenue generated from the SO storage charge relative to the standard SO charge was presented at Gas TCMF (Transportation Charging Methodology Forum) meetings and has been made available on National Grid NTS' Gas Charging web-site. The Pricing Consultation Paper NTS GCM03 also explains (ref. Paragraph 3.4) the suggested approach to allocate a share of each relevant cost element to the proposed Storage SO commodity rate. In National Grid NTS' view the explanation provided in NTS GCM03 together with the supporting material has enabled Industry parties to form a view as to whether the proposed approach is appropriate, indicated by the detailed comments and observations received.

In respect of the possible implementation of the Enduring Exit Reform and its impact on the suitability of the proposals, it is anticipated that any review of the SO storage commodity charge methodology proposals as a result of Exit Reform will not be needed until 2010, when all aspects of the exit regime including the possible use of demand-side, bi-lateral contracts for storage services are implemented.

National Grid NTS acknowledges that there will be a difference in the actual unit costs across the range of NTS storage sites, and that these would vary according to geographical location, size of the installation, compression arrangements and metering configuration amongst other things. However, National Grid NTS is mindful that the proposals put forward need to achieve the right balance between cost-reflectivity and complexity. In particular, a cost-reflective charge developed for each site would introduce significant volatility in the levels of the storage commodity rates due to changes in the forecasts of costs and throughput if taken on a site by site basis.

In respect of whether all SO costs are driven by throughput, National Grid NTS is proposing a cost allocation approach based on gas throughput as a proxy for other cost drivers to avoid complexity in the methodology and to improve certainty in the level of charge rate.

In respect of the benefits that NTS storage facilities to the NTS, in particularly during periods of high system demand, National Grid NTS believes that these benefits highlighted in the responses received are more in connection with provision of system capacity and long term NTS investment decisions. The contribution that NTS storage makes on supporting peak firm load, and in helping maintain supply/demand balance should be reflected in the NTS Entry Reserve Prices for NTS Storage. Furthermore, subject to any future introduction of Enduring Exit Reform, it is envisaged that the benefits that NTS Storage provides to the System Operator would be taken into account in the development and use of any system management services agreements and bi-lateral contracts between the two Operators that Exit Reform may provide.

In respect of the comments put forward by CS about the Rough Storage facility, and the limited use of the NTS that gas entered at Easington and injected at Rough would require, making the proposed unduly penal in such circumstances, National Grid NTS

notes that the Optional NTS Commodity Charge is available that may well be a cheaper alternative to the proposed SO Storage Commodity Charge.

c) Cost-reflectivity - Relevant Cost Elements

As part of National Grid NTS' initial proposals in NTS GCM03, a description of the current SO cost elements that are recovered through the standard SO commodity charge were provided. Users were consulted on the relevance of these cost elements for the proposed SO Storage Commodity Charge. Respondents' views on each of the cost components are detailed below.

Compression

Respondents' Views

Two respondents (CS,GSOG) express agreement with the compression costs being excluded, and furthermore suggest that where storage sites contain their own compression and re-deliver gas back to the NTS at higher pressure, this benefit of providing compression to the NTS needs to be deducted from any proposed charge. RWE states that "*there may be some logic in excluding compressor gas*" but that compression costs may be incurred in transporting gas to, and away from, storage facilities the extent of which would depend on the location of the storage points and other system exit points. AEP suggests that the relevance of whether the gas that flows to storage has used any more or less of the NTS than gas that bypasses storage is also not clear, and that storage facilities located close to entry points may opt for the optional commodity charge. BGT suggests that if the shrinkage costs are such a major portion of SO costs then the reduction (from the standard commodity rate) does not appear to reflect this.

National Grid NTS' response

National Grid NTS welcomes the support expressed by three respondents in principle to the proposal and rationale for excluding compression costs.

The suggestions put forward in some responses to take account of those facilities that provide compression to the NTS, and to consider the precise locality of different storage points, in National Grid NTS' view, would require a level of cost-targeting that would be impractical due to the nature and drivers of compression costs. Hence the approach proposed in NTS GCM03 is based on an assumption that in general the distance travelled by, and hence compression costs associated with, gas transported through the NTS is no greater when it has been stored in NTS storage facilities, than if it has bypassed such facilities. Within the prevailing charging arrangements, Users pay for their contribution to SO compression costs through the standard SO commodity charge at entry and exit to the NTS, and hence an element of double-accounting would arise if the cost was also included in the proposed SO Storage Commodity Charge.

National Grid NTS can confirm that the exclusion of compression costs have been reflected in the "reduced" SO storage commodity rate. Based on the 2006/7 forecast of SO costs at the time NTS GCM03 was published, compression costs accounted for £90m of the total SO allowable revenue of £242m.

Unaccounted for Gas

Respondents' Views

CS observes that where storage facilities use the same meters for both input and output, any errors will tend to net off to zero over time, and it therefore states that it is unreasonable to include metering errors in the proposed charge. On the same point, EDFT suggests that in the event that a single meter is employed for gas entering and exiting a storage facility this cost element is not applicable. Whilst agreeing that storage meters like other NTS exit meters will contribute to unaccounted for gas, GSOG argues that as the application of the charge is proposed to be on UDQOs (User's Daily Quantities Offtake) and UDQIs (User's Daily Quantities Input) and not the net physical flow at any storage point, it is likely that there will be an over-recovery from Storage Users.

RESPONDENT 'A' suggests that costs relating to unaccounted for gas is the liability of the storage owner/operator, and are not incurred by National Grid NTS.

National Grid NTS' response

National Grid NTS acknowledges that there are differences in the metering arrangements across different NTS storage facilities, but that in order to avoid introducing site-specific storage commodity rates and the associated complexity, it was proposed that such differences would not be taken into account. Instead a forecast of the UAG costs across all NTS storage sites in aggregate has been assumed based on the most recent years' historical data.

In respect of the comment raised by GSOG, National Grid NTS agrees that an allocation of UAG costs based on commercial flows rather than physical flows would probably lead to an over-estimate of the level of costs attributed to NTS storage. Therefore National Grid NTS proposes to revise the original proposed methodology in this aspect, such that the attribution of the relevant SO costs to NTS storage is based on physical flows, rather than commercial or contractual flows. This would reduce the SO storage costs from £5.5m to £4.4m, with a corresponding reduction in the proposed SO Storage Commodity Rate, set out in Section 4 (Summary - Final Proposals). This approach would in our view provide a better estimate of the actual costs incurred at NTS storage facilities. For the avoidance of doubt, this revision to the cost methodology described in the Consultation Paper would not affect National Grid NTS' proposal to levy the new charge on commercial or contractual flows (i.e. UDQIs & UDQOs) rather than physical flows.

With regard to the comments made by RESPONDENT 'A', National Grid NTS notes that costs relating to UAG are accounted for within shrinkage costs and hence are recovered via the SO allowable revenue, rather than the liability of the storage owner/operator.

Operating Margins (OM)

Respondents' Views

Two respondents (AEP, RWE) question whether the rationale for excluding operating margins costs should be extended to all interruptible sites that currently pay the full SO commodity rate. AEP observes that if UNC Modification Proposal 0116 is implemented then NTS interruptible status would no longer exist from October 2010. AEP comments that OM gas is also used for the orderly run down of the network, and both respondents suggest that OM costs should not be excluded from storage exit flows.

National Grid NTS' response

National Grid NTS acknowledges the linkage between OM costs and all interruptible sites that respondents have commented on, but it is considered that the potential reduction in SO commodity rate arising from the exclusion of OM costs would be to

such a small degree that it would not justify the complexities involved in introducing different SO commodity rates for firm and interruptible Users.

In respect of the possible implementation of the Enduring Exit Reform, it is recognised that NTS interruptible status would no longer exist from October 2010, and that this may require a review of the SO storage commodity charge methodology at such a time.

Although OM is also used to ensure the safe run down of the network during emergency arrangements, historical data has suggested that this has not led to a significant need for OM, and apportioning OM costs between the different requirements e.g. compressor trips, prior to balancing actions taking effect, would be highly subjective.

Exit Capacity TO costs

Respondents' Views

Six respondents (BGT,CS,EDFT,GSOG,RWE,'A',SSE) query the proposal to include costs from TO charges foregone within the proposed charge. Two respondents (BGT,CS) query the fact that TO charges foregone are recovered via the SO commodity charge which they suggest appears unjustified. Two respondents (CS,GSOG) argue that storage sites are not interruptible in the same way as other interruptible offtakes, as during periods of system stress NTS storage sites will be entering gas into the system rather than exiting it. Two respondents (BGT,Stat) suggest that if Exit Reform is implemented, interruptible status will be removed, with interruptible capacity only available on a daily basis, and would therefore no longer be applicable. Stat comments that if Enduring Exit Reform is not implemented the charge could be included.

Respondent 'A' states in respect of the Exit Capacity TO costs, *"that in relation to this TO charge, any gas brought onto the NTS has already been subject to a Commodity Charge and to introduce an additional commodity charge would be to double charge that gas"*.

National Grid NTS' response

National Grid NTS notes that under the present TO & SO price control formulae, the avoidance of NTS exit capacity charges by interruptible Users is treated as foregone TO revenue which represents a cost on the TO. This cost is rolled into the SO maximum allowable revenue, and recovered via the standard SO Commodity Charge. The SO funds the TO for this "lost revenue". These arrangements were introduced as part of the TO and SO price controls in 2002 as it was anticipated that Universal Firm Registration would take effect in 2004, and therefore in 2002 the TO allowable revenue amount was set on the basis of all NTS Users paying capacity charges.

The amount of "foregone revenue" is accrued from all types of interruptible sites, including TNIs (Transporter Nominated Interruptible), SNIs (Shipper Nominated Interruptible), NSLs (Network Sensitive Loads) and storage sites, irrespective of their respective patterns of interruption.

National Grid NTS acknowledges that Enduring Exit reform, if implemented, would have an effect on the present interruptible arrangements, including the treatment of "foregone revenue" and that this may require a review of the proposed SO storage commodity methodology.

In respect of the comment raised by Respondent 'A', National Grid NTS can confirm that the proposal to include an element of the "foregone" revenue TO cost within the proposed SO Storage Commodity Charge is unrelated to the application of the TO commodity charges at NTS entry points.

Revenue Adjustments

Respondents' Views

GSOG suggests that due to the flow characteristics of storage sites, then it is inappropriate to adjust the proposed Storage Commodity Charge for any SO under/over-recovery. On a similar point, CS expresses the view that the majority of variable SO costs that can lead to SO under/over-recovery are not related to storage points, and therefore any adjustments should not be incurred by storage facility Users. Respondent 'A' argues that any adjustment of the proposed storage charge and other NTS tariffs due to any under/over-recoveries "*will lead to unpredictability for all parties and will potentially create a charging system of unnecessarily complex recalculations and rebates*". EDFT queries what proportion of under/over recoveries will be targeted at the Storage Commodity Charge, and expresses concern that the proposal does not attempt to quantify the cost allocation methodology. SSE suggests that due to charges being forecast driven and in the interest of cost reflectivity, Storage SO Commodity Charge revenue is collected separately from other SO Commodity charges, rather than all SO Commodity Charges revenue being collected as one.

BGT queries the reference to the outcome of the SO Incentive schemes stating that these are generally funded by the SO taking a proportion of the revenue (or charge) generated from their operation, rather than subsidised by a general revenue collection across all users by means of the SO Commodity charge.

National Grid NTS' response

National Grid NTS proposed in NTS GCM03 that a single SO commodity under-over/recovery mechanism would continue to operate as at present, and that this would comprise of under-over/recoveries arising from both the Standard and the Storage SO Commodity Charges.

Having taken into account the comments received about potential volatility, and uncertainty arising from under-over/recoveries, National Grid NTS remains of the view that these concerns are best overcome by the continued use of a single combined under-over/recovery mechanism. National Grid NTS believes that uncertainties in the forecast level of SO costs and throughputs, that could affect both the standard SO charge and the proposed SO commodity charge are best mitigated by a single under-over/recovery mechanism, as it spreads the forecasting errors over a larger revenue recovery base. It believes that the introduction of a specific under-over/recovery mechanism based on a target revenue against actual revenue for the proposed SO storage commodity charge would lead to greater complexity in the charging methodology and greater volatility in the same charge.

In respect of the query raised regarding the outcome of the incentive schemes, National Grid NTS can confirm that any percentage share of revenue/cost derived from the SO incentive schemes is solely a means of measuring its performance against defined targets and caps and collars. Any consequential cost or revenue due to National Grid NTS arising from its performance is currently recovered via the Standard SO Commodity Charge in accordance with the existing charging methodology. The proposal in NTS GCM03 would leave this arrangement unchanged.

Internal Costs

Respondents' Views

Two respondents (CS,EDFT) argue that administration and data handling costs are not related to throughput, but primarily a function of the number of meters. Any

allocation of these costs based on commercial flows would, they suggest, represent a disproportionately high charge. GSOG expresses concern that including this cost element could lead to double charging given that the standard commodity charge contains an element of these costs, and that it is unclear how they should be apportioned to avoid double charging. GSOG further argues that to avoid this, the recovery of these costs is best aimed at a non-storage NTS exit point. CS acknowledges that storage facilities lead to internal IT storage costs and personnel costs on National Grid NTS however these are less than other sites due to the fact that the storage metering systems are managed, maintained and owned by the storage facility operators.

Respondent 'A' argues that *"costs relating to property, staff and IT systems would be charged more appropriately by the storage owner/operator who incurs the cost, not by the National Grid"*. It argues further that any related internal costs have been catered for in the proposed charge relating to Shrinkage – Storage Meters.

National Grid NTS' response

Whilst accepting that administration and data handling costs are not directly related to throughput, but possibly the number of accounting meters, the suggested approach outlined in NTS GCM03, in National Grid NTS' view, would avoid complexity in the charging methodology and improve certainty in the level of charge rate. It would also represent a consistent approach with that applied for the Standard SO Commodity Rate.

In response to concerns about "double-charging" of costs, National Grid NTS notes that the portion of SO internal costs included in the proposed SO Storage Charge would be removed from the standard SO commodity Charge thus avoiding any "double-charging" of costs.

In respect of the concern expressed that allocating the costs on commercial flows rather than the number of meters would lead to a disproportionately high charge, National Grid NTS can advise that, for information, due to the relatively low flows at storage sites compared to non-storage points, allocation based on number of meters would lead to a higher charge rate.

In respect of Respondent 'A's comments, National Grid NTS is unaware of any proposed charge relating to Shrinkage – Storage Meters.

d) Potential Discrimination

Respondents' Views

Three respondents (AEP, EDF, EON) comment on the apparent lack of consistency in Ofgem's views expressed in respect of NTS Exit Reform that all offtakes should be treated the same, and in respect of the potential for a cost-reflective charge for storage sites. Whilst noting that tariffs should also reflect other factors, AEP makes reference to EU gas regulation 1775/2005 on conditions for access to gas transmission networks, and refers to an explanatory note on tariffs (currently in draft) shortly to be issued by DG TREN that states: *"Tariffs for identical services offered by individual TSOs should be identical. Tariffs must be the same for the same service for all system users. Discounts or any other special treatment is not allowed anymore"*. AEP further states, however, that *"This is not a position that the industry generally supports and considers that it would not be unduly discriminatory to provide different services to different types of offtakes"*. AEP also questions whether the service provided by National Grid NTS in providing capacity and transporting gas to storage

offtakes is different from that provided at other offtakes. If the service is different then it may be appropriate to apply a different charge.

AEP states that it does not understand the argument for applying a different commodity rate for storage own use gas and gas which uses the same transportation network and route that is stored and subsequently re-injected into the network, suggesting that there was a case for this when the whole system, including storage was owned and operated by the same entity.

EDF states that whilst they do not argue that storage sites should be treated like any other NTS exit points, it questions why this distinction does not apply to other Exit points such as DN and smaller industrial NTS supply points.

EON makes reference to their response to Modification Proposal 0116a (Enduring Offtake Arrangements) where it argues that the assumption that all NTS Offtake Users should be treated the same is not appropriate. EON quotes a legal view they have received from counsel and concludes that where *“various classes of NTS User are not materially comparable, that there are valid reasons for their different treatment and as such different treatment is appropriate.”* EON further states *“that Modification Proposal 0120 in its current format would support our argument for validly treating NTS Offtakes differently, through positive discrimination, by levying a reduced commodity charge rate on storage flows.”*

National Grid NTS’ response

National Grid NTS notes the range of views that have been put forward in respondents’ comments and at recent Industry Gas TCMF Meetings regarding whether the proposed SO Storage Commodity Charge could be deemed as “undue discrimination”. National Grid NTS believes that the interpretation of whether these proposals are duly or unduly discriminatory needs to be taken in the context of our wider GT objectives and the intention of the proposed charges. National Grid NTS’ primary GT licence objective with regard to changes to its transportation charging methodology is whether they better reflect the actual costs incurred which, in our view is met by the proposals in NTS GCM03. This proposal also takes into account Ofgem’s previous rejections of Transco’s earlier proposals to apply the full SO commodity rate. With regard to issues of whether the proposed charge would be “unduly discriminatory”, it is anticipated that these will be taken into consideration by the Authority in their decision making process.

In respect of AEP’s concerns over different rates for OUG and storage flows, UNC provides for the application of the full SO Commodity Charge for OUG as it is gas that is utilised by the storage facility and hence is deemed to exit the System at that point, in common with all other NTS Exit Points. This differs to gas that is stored in NTS storage facilities and re-enters the NTS, which consequently incurs the full SO Commodity Charge on exiting the NTS at an Exit Point, whereby the application of the same level of charge on gas that is “parked” in NTS storage could be viewed as “double charging”.

e) Impacts on Gas Storage Business

Respondents’ Views

Six respondents (BGT,EDF,EON,‘A’,Stat,‘B’) express concern with the potential impact the proposed charge could have on the storage business, particularly now that

the UK becomes increasingly reliant on imported sources and the need for storage investment increases. EON expresses concern that the charge could detract from its market effectiveness and competitiveness. BGT suggests that it is therefore relevant to judge the impact of a pricing proposal such as this upon the incentives on Users to book and use capacity and deliverability for the needs of their portfolio. It also suggests that it is important to consider the influence upon potential developers of storage facilities where these proposals may impact the economics of the project. EDF argues that *“implementation of this proposalwill give out a perverse signal and have a negative impact on the development of gas storage facilities.”*

National Grid NTS’ Response

National Grid NTS acknowledges the potential impact that the proposed charge would have on the storage business, and hence has sought to ensure that any proposed SO Storage Commodity Charge would be a discount on the full SO Commodity Charge, taking into consideration the nature of storage. In addition, it believes that the additional cost on Storage Users (of 0.0055 p/kWh) would not represent a significant increase on the total storage charges Users currently face. National Grid NTS also needs to be mindful of its licence obligation to keep its transportation charging methodology at all times under review for the purposes of ensuring that the charging methodology achieves the relevant methodology objectives. However, it does recognise that this will lead to winners and losers among all System Users depending on their individual portfolios.

f) Application of Charge

Respondents’ Views

Six respondents (EON,EDF,GSOG,SSE,Stat,AEP) question how the proposed charge would reflect the costs incurred when the charges are to be applied on commercial nominations rather than physical flows. They suggest that the proposed charge needs to be based on actual net physical offtake flows rather than contractual offtake allocations. GSOG suggests that the current approach to apply charges to commercial flows at bi-directional offtakes is not valid. By way of examples, EDF notes that a User’s nomination that reduces a storage facility’s physical flows would reduce the costs imposed on the system, and yet would encounter a charge under this proposal. Stat notes that where a storage site nominates to withdraw 100 units and also inject 100 units creating a net flow of zero, they would be charged for 200 units even though no gas has flowed.

RWE argues that it is right for the storage commodity charge to be applied to both the entry and exit flows in the event that gas is physically withdrawn and re-injected at a later date. However, RWE also suggests that if the difference between physical and commercial flows are significant, then any storage commodity charge could be charged to the storage operator (as shipper).

National Grid NTS’ response

National Grid NTS recognises respondents concerns regarding whether the proposals could be more cost-reflective by applying the proposed charge to physical flows. However, the suggested approach in GCM03 is consistent with one of the principles of the UNC that charges are based on User’s Daily (Allocated) Quantities (known as

UDQOs for offtakes and UDQIs for inputs). These UNC defined terms are used for calculating transportation charges and energy balancing charges, and in the case of bi-directional offtakes are allocated by the CSEP operator against each User's input and output accounting meter, rather than taking a net position. Any proposal to derive a commodity charge based on a net position would introduce a significant inconsistency in the charging arrangements, both between different types of bi-directional offtakes and between how energy balancing charges and transportation charges are generated. Consequently, National Grid NTS would not be in support of such a proposition.

In response to the comments received, National Grid NTS has undertaken some analysis to establish the significance of any difference between commercial or contractual flows (i.e. UDQOs or UDQIs) and to assess the extent of "netting off" of within-day flows. Based on an average of all the major NTS storage sites over the most recent gas year (Oct 2005 – Sept 2006), and by recording daily stock changes, National Grid NTS can advise that the aggregate quantity of daily commercial flows (i.e UDQOs & UDQIs) over the year is approximately 15% greater than the aggregate quantity of daily physical flows over the year. Consequently, it believes that the difference is not as significant as suggested in representations, and would not justify the introduction of inconsistent arrangements and the additional systems complexity that it would create.

g) Implementation Issues

Respondents' Views

Respondent 'A' puts forward the view that the new charge has the "potential to change the balance of risk to existing contracts" which have been based on the current structure of transportation charges. Respondent 'A' notes that the proposed implementation date *"falls before the end of the storage year and therefore will inevitably impact existing contracts"*.

Respondent 'A' also suggests that the proposed implementation date raises questions about suitable notice periods for changes to the SO Commodity Charge and stresses the importance of adhering to an appropriate notice period to assist users to plan their businesses efficiently. It also argues that the *"imposition of a new Charge that impacts pre-existing business contravenes the requirement in EC Regulation 1775/2005 that the network tariff should facilitate "efficient gas trade and competition"*.

Respondent 'A' requests clarification that changes to National Grid's billing systems would be affected in time for the proposed implementation date, and requests acknowledgement that changes in systems impact not only National Grid, but also the systems of the shippers impacted by the proposed charges.

SSE notes that the forecasting accuracy of the number of storage facilities and their modes of operation will be important in determining the Storage SO Commodity Charge. It also observes that it will be very difficult for NGG to forecast the usage accurately a year in advance as the operation of these facilities will be determined by the volatility of price and other commercial drivers. SSE suggests that to manage this a methodology that allows for storage operators and Users to offer their assumptions of usage may provide more accurate forecasts.

National Grid NTS' response

National Grid NTS recognises the potential impact the proposed new charge would have on existing shipper contracts, and has sought to mitigate this by providing the Industry as much as notice as possible through the Gas TCMF Industry meetings and the 150 day Indicative Notice of Transportation Charges to Industry. National Grid NTS is obliged by its GT Licence to introduce changes to its transportation charges only on 1 April and 1 October of each formula year.

National Grid NTS can confirm that the necessary changes to its billing systems would be effected in time for the proposed implementation date, although any changes are expected to be minimal as existing invoice types and charge types would be utilised. National Grid NTS also recognises that shippers' billing systems may also be impacted, although no detail on the extent of this has been brought to our attention.

National Grid NTS acknowledges the importance of forecasting expected annual storage flows and costs in setting an appropriate level of charge rate, and welcomes the suggestion to allow storage operators and Users to offer their assumptions of expected usage. Analysis of overall storage usage over recent years, however, has suggested a reasonably predictable trend of storage flows, and together with enquires and firm proposals received regarding new storage connections that National Grid NTS receives, this information should be sufficient for the needs of these proposals. National Grid NTS intends to keep this aspect under review, however, and if it is considered necessary, it could be possible to introduce a mechanism to formally request forecasts via, for example, the TBE (Transporting Britain's Energy) process.

4. Summary - Final Proposals

Having considered all the respondents' views, and taking into account the detailed points put forward, National Grid NTS remains of the view that the introduction of a cost-reflective SO commodity charge for NTS storage facilities would better facilitate its GT licence objectives. The current situation whereby Users of NTS storage facilities do not incur any SO commodity charge is, in our view, inappropriate as it results in Users at other NTS Entry and Exit Points cross-subsidising such Users.

In developing this proposed charge, National Grid NTS believes that it has taken into account the views of the Authority in its decision letter on Network Code Modification Proposals (0532, 0544 & 0547), and developed a charging methodology that better reflects the actual costs incurred, which seeks to avoid double-accounting.

However, in light of comments received, National Grid NTS intends to revise one of the aspects of the proposed methodology contained in GCM03 in the following area:

- the apportionment of the relevant SO cost elements to the Storage charge to be based on physical flows rather than contractual or commercial flows as originally proposed

Based on the same forecast of storage gas flows and SO costs used in GCM03, this would result in a revised figure for the proposed SO Storage Commodity charge of **0.0055 p/kWh**, compared to the original proposed figure of 0.0065 p/kWh. This would be expected to generate an SO revenue of **£4.4m** for the current formula year.

These revised figures would not alter the predicted value of the standard SO commodity rate given in the Consultation Paper GCM03 of 0.0112 p/kWh.

In summary, National Grid NTS' revised proposals are as follows:

- an SO Commodity Rate is applied to all NTS storage input and output gas flow allocations (the "Storage SO Commodity Rate") at a lower rate than currently

applicable for all entry and exit gas flow allocations (the “Standard SO Commodity Rate”);

- the Storage SO Commodity Rate is determined by excluding relevant SO costs in respect of compressor gas and Operating Margins (which are included in the Standard Commodity Rate) as they are not considered to be driven by the operation and ongoing support of NTS storage facilities and would hence minimise the potential for double charging;
- any adjustment in charges arising from the outcome of the SO incentives schemes remains with the Standard SO Commodity Rate, consistent with its purpose of ensuring National Grid NTS recovers its SO allowable revenue, and to ensure the forward-looking cost-reflective approach of the proposed Storage SO Commodity Rate is maintained;
- the Storage SO Commodity Rate is based on a forecast of physical flows rather than commercial flows; and
- the new Storage SO Commodity Rate is implemented from 1 April 2007, subject to Ofgem approval of UNC Modification Proposal 0120.

The proposal, if implemented, would not change:

- the target level of revenue to be recovered through NTS SO Commodity Charges²; and
- the current charging arrangement in respect of storage own-use-gas quantities which attract the Standard SO Commodity Rate.

In summary, National Grid NTS believes that these final proposals would satisfy the relevant objectives set out in its GT Licence as follows:

I. Reflect the costs incurred by the licensee in its transportation business;

The proposed new charge has been derived based on a methodology that identifies those SO costs that can be readily attributed to the administration and support of storage sites by the system operator, and therefore is considered an approach that better reflects the costs incurred by National Grid NTS. The proposal should also address concerns that the alternative options of either applying the full SO Commodity Charge at storage or continuing to levy a zero commodity charge are not cost reflective.

II. So far as is consistent with (1) properly take account of developments in the transportation business;

The increasing importance and number of NTS storage facilities could be argued to prompt the need to introduce a specific SO storage commodity charge set at a level appropriate to the impact on the relevant SO costs of supporting such storage sites. Furthermore, introduction of the charge would ensure consistency with the intent of PC73 “Structure of the NTS SO Commodity Charge”, April 2002.

III. So far as is consistent with (1) and (2) facilitate effective competition between gas shippers and between gas suppliers.

² The Standard SO commodity rate, the proposed SO storage commodity rate, the NTS Optional commodity rate, & the St Fergus compression charge

The proposed Storage SO Commodity Rate would address the current situation whereby Users of NTS storage facilities do not incur any SO commodity charge which results in Users at other NTS Entry and Exit Points cross-subsidising such Users. National Grid NTS therefore considers that the proposed methodology for the Storage SO Commodity Rate would facilitate effective competition between gas shippers and between gas suppliers.