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By email: National Gas Transmission – box.gsoconsultations@nationalgrid.com,
cc.: colin.williams@nationalgas.com

23 June 2023

Dear Colin

RE: National Gas Transmission's NTS Gas Charging Discussion Document Consultation

South Hook Gas Company Ltd. ("**SHG**") welcomes the opportunity to respond to the above consultation on potential changes to Gas Transportation Charging arrangements published by National Gas Transmission plc ("**NGT**") on 28 April 2023[1] ("**Consultation**"). This letter comprises our response to the questions raised in the discussion paper forming part of the Consultation ("**Discussion Paper**").

1. Impacts of ECs

1. Do you agree that Existing Contracts are having a significant impact to Transmission Services Entry Reserve Prices?

As set out in our response to the 2019 consultation on proposed modifications to UNC 0678, we do not consider that the pricing differential associated with 'Existing Contracts' (ECs) has a material or long-lasting impact on consumer welfare or the broader gas market. Further, the impact of ECs is declining every year as the share of ECs declines[2].

The information provided in the Discussion Paper does not adequately demonstrate that ECs have a material distortive impact on competition. We note that there is no consideration in the analysis of the potential impact of short haul and trading of ECs on competition in the wholesale gas market. Further, there is no analysis of the distribution of ECs across entry points and their relative average prices and duration. Such information is important in order to take a view of the potential impacts on competition of ECs and the corresponding benefits and costs of the entry-focussed solutions (particularly, the commodity charge on utilised ECs). We also note that previous analysis by Baringa[3] (UNC 0678) and Frontier Economics[4] (UNC 0790) have suggested that the impact of ECs on competition is unclear.

Given this, while the analysis presented by NGT shows that there is a differential in the average price of ECs compared to the prevailing standard capacity reserve prices, the insufficiency of evidence that ECs are having a negative impact on the gas market means that direct intervention cannot be warranted.

[1] www.nationalgas.com/charging/gas-charging-discussion-gcd-papers (as amended 4 May 2023)
[2] https://www.gasgovernance.co.uk/sites/default/files/ggf/book/2019-05/Representation%200678%20-%20South%20Hook%20Gas.pdf
[3] https://www.gasgovernance.co.uk/sites/default/files/ggf/book/2019-04/Tariff%20differentials%20between%20new%20and%20existing%20contracts%20-%20Baringa%20report.._.pdf
[4] https://www.gasgovernance.co.uk/sites/default/files/ggf/book/2021-11/NGG%20Charging%20Reform%20-%20Impact%20Assessment%200790%20%28Urgent%29.pdf

2. *Do you believe there should be some remedy to limit/reduce/remove their influence?*

No. As set out above, SHG considers that the Discussion Paper does not provide sufficient evidence that the differential between ECs and standard capacity reserve prices is having a negative impact on competition. Without this evidence, an intervention targeted at ECs cannot be justified.

3. *Should there be any treatment, different to the status quo, for ECs and how they are accommodated and charged in the Charging Methodology?*

No. We do not consider that changes specific to the treatment of ECs should be made to charging arrangements. Indeed, SHG is concerned that the main targeted intervention of introducing a commodity charge on utilised EC capacity could have negative consequences for the GB gas market and investment in network expansion.

The UK is already a relatively higher cost destination for landing LNG compared to EU LNG receiving terminals. This is attributable to the UK's relatively higher entry capacity charges, along with other regulatory constraints (Wobbe limits and processing equipment). Our analysis of the TO commodity charge suggests that it will make it even more expensive to bring LNG into the UK via South Hook in winter. This impact will be further exacerbated should the EU member states implement proposals to introduce a 100% discount on entry capacity charges for LNG[5] entry points in EU member states.

Further, we note that, were this option to be progressed, the interaction between treatment of EC capacity and incremental capacity bookings would need to be carefully considered. This is particularly relevant to investment in GB terminal expansion projects. SHG previously flagged concerns around the introduction of a commodity charge in relation to UNC 0790[6]. These concerns are still valid as there is a potential for a TO charge to be applied to EC, increasing the costs associated with terminal expansion. This issue would be realised if South Hook's entry capacity is not being fully utilised on a given day, but cargoes were delivered to SHLNG terminal as part of the terminal capacity expansion project. Unless the booked incremental capacity is ring-fenced, tagged, or prioritised in some way, these volumes of LNG are likely to face TO commodity charge on NTS entry. This is because the NTS systems would not be able to differentiate which type of entry capacity (EC or Incremental Capacity) the gas is being delivered against. The NTS systems would therefore be likely to assign it against EC first. This increases uncertainty associated with the costs of the SHLNG terminal expansion project.

Finally, SHG does not consider that an EC-specific commodity charge can be compliant with NC TAR[7]. Article 35(1) of Commission Regulation (EU) 2017/460 provides that:

"*This Regulation shall not affect the levels of transmission tariffs resulting from contracts or capacity bookings concluded before 6 April 2017 where such contracts or capacity bookings foresee no change in the levels of the capacity- and/or commodity-based transmission tariffs*

[5] https://data.consilium.europa.eu/doc/document/ST-7909-2023-INIT/en/pdf
[6] https://www.gasgovernance.co.uk/sites/default/files/ggf/book/2021-12/Representation%20-%20South%20Hook%20Gas%20Company%200790.pdf
[7] Commission Regulation (EU) 2017/460 of 16 March 2017 establishing a network code on harmonised transmission tariff structures for gas (https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32017R0460)

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except for indexation, if any."

"Transmission tariffs" for the purposes of NC TAR include both capacity- and commodity-based charges. Article 35(1) safeguards the legitimate expectations of parties who entered into long term contracts for the acquisition of capacity at a fixed price on the basis of the prevailing regulatory regime for access to transmission systems prior to TAR coming into force. The imposition of a new commodity-based tariff on ECs would clearly be contrary to those expectations and the clear wording of Article 35(1) of NC TAR.

SHG notes Ofgem's interpretation of Article 35(1) in its decision letter for Mod 0790[8]. SHG contends that the correct construction of the wording is the more natural interpretation set out above, ie a simple prohibition on imposition of a new commodity-based transmission tariff on ECs.

SHG also does not see how the basis for application of this proposed tariff meets the requirements of Article 4 of NC TAR around setting compliant commodity-based transmission tariffs.

As has been discussed in industry meetings, Ofgem is ultimately the arbiter of compliance and its views on compliance have varied from legal advice industry participants have procured. Therefore, before investing significant time and resource into analysing any options for changing charging arrangements, industry needs greater comfort that the proposal it is developing has a high likelihood that it can be implemented.

2. TS Entry-focussed options

4. *Do you think any of these options provide a more suitable approach to Transmission Services Charging achieving an objective of more competitive TS Entry charges? If so, please include why this would be beneficial to competition.*

As the impact of ECs on competition has not been clearly articulated in the analysis presented in the Discussion Paper, we cannot take a view on how any of the proposed Transmission Services (TS) entry-only options would improve competition.

Given Ofgem's determination on UNC 790, we also do not believe a commodity charge on all entry points or all entry and exit points can be compliant with NC TAR.

We do not support options which seek to limit flexibility associated with trading of ECs. Article 22 of Regulation (EC) 715/2009 on conditions for access to the natural gas transmission networks provides that:

"*Each transmission, storage and LNG system operator shall take reasonable steps to allow capacity rights to be freely tradable and to facilitate such trade in a transparent and non-discriminatory manner. Every such operator shall develop harmonised transport, LNG facility and storage contracts and procedures on the primary market to facilitate secondary trade of capacity and shall recognise the transfer of primary capacity rights where notified by system users.*"

SHG considers that the application of an additional charge to a specific class of capacity rights

[8] Discussion Paper, p.13

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(ECs) or upon the use of such capacity rights once transferred (ie loss of grandfathering) is a retrograde step in ensuring that the capacity is "freely tradeable".

5. *Are there any other options or refinements / amendments / specific treatment within these options that should be considered and why?*

SHG does not support any of the proposed TS entry-focused options. Further, treatment of incremental capacity is omitted from the Discussion Paper, which is fundamental for future UK NTS expansion.

6. *Should there be any additional things to consider (e.g. capacity hand-backs)*

SHG does not have views on this question at this point in the process. Should work on a particular option or subset of options be progressed, we will offer views on what additional things should be considered.

3. Broader approach to making UK more attractive to landing gas

7. *Are there merits in reviewing Transmission Services Charging on a broader perspective, recognising that this would encompass Entry and Exit?*

SHG strongly believes there is merit in reviewing Transmission Service Charging on a broader perspective that would include consideration of how allowed revenues are split between entry and exit capacity.

If Ofgem is concerned that the differential between costs for ECs and standard capacity could be distorting competition and the efficient operations of the network, it is SHG's view that Ofgem should also be considering similar issues associated with the differential between entry and exit charges. SHG understands that the differential between entry and exit charges may be greater in some instances than the differentials between the charges for ECs and standard entry capacity charges. Further, as shown in the Discussion Paper, rebalancing the entry/exit split will significantly reduce the impact of any differential between ECs and standard capacity.

In addition, we believe that rebalancing of entry / exit capacity charges can be done in a manner compliant with NC TAR. EU member states already recover more allowed revenues from exit capacity relative to entry capacity. Furthermore, such changes may have positive impacts on UK security of supply as it would bring capacity charges down to similar levels to those in the Netherlands and Belgium.

8. *What, if any, objective could this aim to achieve?*

SHG view is that a broader review of charging arrangements should consider how rebalancing exit and entry charges delivers against the Transporter's relevant objectives. Particularly objectives (a) (efficient and economic operation of the pipeline system), (d) (securing effective competition) and (g) (compliance with the Regulation). SHG considers that, of all the options set out in the Discussion Paper, the option of rebalancing entry and exit charges meets these objectives.

In addition, we consider that a broader review of charging arrangements should consider the competitiveness of the UK gas market in relation to EU member states. As set out above, the UK is already at a competitive disadvantage in attracting LNG cargoes relative to EU member states, with current entry charges being a significant factor. Any changes which increase entry

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capacity charges for LNG terminals in the UK will make the UK an even less attractive destination for LNG cargoes. This risk could be further exacerbated should European Council proposals that EU LNG terminals receive a 100% discount from entry capacity charges be implemented[9].

Further, a broader review of charging arrangements should also consider the consistency between different parts of the code as well as arrangements set out in relation to network access which are specified in supporting documents. For example, in response to modification 0790, SHG set out the challenges created by changes relating to commodity charges on the arrangements for committing to incremental capacity. However, because the arrangements for signalling demand are set out in the Capacity Methodology Statement, we could not propose changes to those arrangements, nor code the impacts of that UNC modification proposal on incremental capacity signalling arrangements[10]. We consider that issues like this need to be addressed in a broader review to ensure any changes progressed through such a review do not have unintended consequences on other related and impacted arrangements for procuring network capacity.

9. *Should a discussion and review of, for example, a change to the 50/50 split be a deliverable for any such review?*

Yes. As set out above we believe that a broader review should be conducted. Further, we consider that the review should focus on the proposal for a balanced regime which utilises a dynamic approach to splitting allowed revenues more equally across all entry and exit points.

4. Overall view

10. *Assuming an initial conclusion that something should be done (subject to views) do stakeholders agree that we should explore:*
    a. *TS Entry only?*
    b. *A wider scope i.e., Transmission Services as a whole?*

As set out above, SHG considers that there is merit in a broader review of charging arrangements (which would appear to be consistent with the requirements of the NC TAR).

11. *Is there anything not covered in this initial review that would be beneficial to take into consideration to facilitate advancing discussions on optioneering selection / direction / development for 2024 and beyond?*

As set out above, SHG considers that any further review should also take into account the competitiveness of the UK to attract gas and ensure that any further changes to the code do enhance the UK's competitiveness and do not have potential negative impacts on investment signals.

[9] Although proposed to be limited until the end of 2025, there is a reasonable probability that the discount could be extended beyond that date.
[10] https://www.nationalgas.com/document/143021/download

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We hope this response is of assistance. Should you wish to discuss further or have any questions please contact Antony Miller at amiller@southhookgas.com and +44 (0)7787524566.

Yours sincerely,

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