

REVIEW GROUP TERMS OF REFERENCE [DRAFT]

Review of NTS Entry Charge Setting Arrangements

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Background

National Grid is launching a fundamental review of entry charging principles. This is in response to growing industry concern about the increasing rate of the TO entry commodity charge.

Early experience of entry capacity auctions (1998 - 2002) was of bidding behaviour resulting in significant revenue over recovery. This may have been due to northern constraints and competition for St Fergus capacity, and limited experience of entry auctions. This behaviour resulted in charging methodology proposals that looked at resolving over recovery and reducing entry capacity floor/reserve prices.

Recent Experiences (2002 - Present) is of bidding behaviour resulting in under recovery, other than when a constraint became material in the Easington area. This may be due to a number of factors including; increased experience of auctions and lack of locational competition for capacity, increased certainty of capacity availability associated with baselines, profiling of capacity across the year, the clearing obligation and zero reserve prices. This behaviour has resulted in the introduction of the TO Commodity Charge and its increasing rate over the years.

Shippers have an incentive to 'wait and see' due to entry capacity price discounts on day ahead (33%) and within day (100%) auctions. Any shortfall in the recovery of revenues by National Grid through entry charges is picked up through the Commodity Charge paid by all shippers. This could mean that short term capacity buyers are having their costs paid by shippers who have previously paid the longer term rate for capacity.

It could be argued that this creates;

- cross subsidies between shippers who buy long term rather than short term,
- cross subsidies between shippers who buy firm rather than interruptible,
- interruptible capacity that is effectively firm if firm capacity remains unsold,
- potential undue discrimination for new ASEPs which have no access to zero priced capacity as there are no short term auctions

Nature and Purpose

This Review Proposal is intended to allow a review of the existing NTS entry charging arrangements to determine if they are still appropriate and consistent with the charging relevant objectives. The review will focus on entry revenue recovery from the available capacity products and the impact of the commodity charge on the distribution of costs on shippers by each aggregated NTS entry point.

Deleted: Where applicable, the review will cover exit reserve price setting to seek to ensure an appropriate level of consistency taking into account the products made available.

Review Group Terms of Reference

Objectives

Identify any charging methodology and/or UNC modifications required to;

1. Continue to recover allowed revenue while achieving the NTS Licence and EU relevant charging objectives.
2. Maximise the proportion of NTS TO target entry revenue recovered through entry capacity charges.
3. Appropriately incentivise long term booking of NTS Entry Capacity.
4. Appropriately differentiate by price between the NTS Entry Capacity products made available.
5. Incentivise Security of Supply.

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1. Topics for Discussion

The following topic items are included within scope of the group and should be considered within the Terms of Reference:

1. General review of the current NTS Entry charging arrangements to determine if they are still appropriate and consistent with the charging relevant objectives.
2. Review of the current NTS Entry Capacity tariff setting methodology within the gas Transmission charging methodology. The prevailing charging methodology transport model used for estimating Long Run Marginal Costs is excluded from the scope of this review; however reviewing inputs to the model is not excluded. The level of forecast unutilised, or 'spare' capacity, should be considered.
3. Review proposed developments within the Electricity Transmission Charging Regime and identify any potential parallels with gas Transmission
4. Establishment of a principles-based approach to determining the level of reserve prices across the gas entry auction frameworks taking into account the products made available and the timescales of capacity release.
5. Review of the current NTS Entry under and over recovery mechanisms, including the commodity tariff setting methodology, within the gas Transmission charging methodology.
6. Implications of identified changes on UNC defined firm and interruptible capacity release and charging arrangements.

2. Suggested Aims and Outputs

It is envisaged that this Review Group will produce a report recommending any necessary changes to the entry charging methodology and UNC. This will form the basis of any future charging discussion and or charging modification proposals brought forward. Any lessons learned that may be applicable to the exit regime will be recorded and reported back to the Workstream and TCMF.

3. Scope and Deliverables

The Review Group shall focus on changes to the Gas Transmission Charging Methodology, but also identify where improvements could also be made to the UNC. The Review Group shall not necessarily be limited by the Gas Transporter Licence in respect of the NTS and hence may identify requirements for consequential changes resulting from Charging Methodology and UNC change proposals.

4. Limits

The Review Group will focus on developing recommendations and Charging Modification Proposals that;

- efficiently address any issues identified in a proportionate and cost effective manner
- allow National Grid to recover its allowed revenue
- allow National Grid to discharge its Licence obligations in regard to making all Obligated NTS Entry Capacity available

The Review Group will consider consequential changes required to procedures and processes within the UNC and will report to the Transmission Workstream

APPENDIX A: Relevant Objectives

Licence Objectives

The National Grid Gas plc Gas Transporter Licence in respect of the NTS requires that proposed changes to the Charging Methodology shall achieve the relevant methodology objectives.

Where transportation prices are not established through an auction, prices calculated in accordance with the methodology should:

- 1) (a) Where transportation prices are not established through an auction, prices calculated in accordance with the methodology should reflect the costs incurred by the licensee in its transportation business;
- 1) (bb) Where prices are established by auction, either
 - no reserve price is applied, or
 - that reserve price is set at a level best calculated to promote efficiency and avoid undue preference in the supply of transportation services; and
 - best calculated to promote competition between gas suppliers and between gas shippers;
- 2) So far as is consistent with (1) properly take account of developments in the transportation business;
- 3) So far as is consistent with (1) and (2) facilitate effective competition between gas shippers and between gas suppliers.

Assessment against EU Gas Regulations

EC Regulation 1775/2005 on conditions for access to the natural gas transmission networks (binding from 1 July 2006) are summarised below. The principles for network access tariffs or the methodologies used to calculate them shall:

- Be transparent
- Take into account the need for system integrity and its improvement
- Reflect actual costs incurred for an efficient and structurally comparable network operator
- Be applied in a non-discriminatory manner
- Facilitate efficient gas trade and competition
- Avoid cross-subsidies between network users
- Provide incentives for investment and maintaining or creating interoperability for transmission networks
- Not restrict market liquidity
- Not distort trade across borders of different transmission systems.