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ACER
Agency for the Cooperation of Energy Regulators

Agency Report

Analysis of the Consultation Document on the Gas Transmission Tariff Structure for Great Britain

NRA: Office of Gas and Electricity Markets (Ofgem)
TSO: National Grid Gas Transmission (NGGT)

24 April 2020

Contents

1. ACER conclusion

(1) The British NRA, the Office of Gas and Electricity Markets (Ofgem), proposes a postage stamp reference price methodology ('RPM') with a 50/50 entry-exit split that would be implemented as of 1 October 2020. Ofgem proposes to apply 50% discount to the entry to and the exit from storage facilities. No commodity-based transmission tariffs is proposed, but costs corresponding to non-transmission services will be recovered through a commodity-based charge.

(2) Moreover, Ofgem proposes that existing capacity contracts concluded before 6 April 2017 will not be affected by the new RPM in accordance with Article 35 of the NC TAR.

(3) The Agency, after having completed the analysis of the consultation document pursuant to Article 27(2) of Commission Regulation (EU) 2017/460 of 16 March 2017 establishing a Network Code on Harmonised Transmission Tariff Structures for Gas ('NC TAR'), concludes that:

- The consultation document contains the required information listed in Article 26(1) of the NC TAR;
- The choice of the postage stamp methodology as the proposed RPM is overall compliant with the requirements set out in Article 7 of the NC TAR;
- The results of the comparison with the counterfactual Capacity Weighted Distance ('CWD') methodology show a reasonable level of cost-reflectivity;
- The simplified tariff model is in line with the requirements of Article 30(2)(b) of the NC TAR;
- Network users would be able to reproduce and forecast the reference prices using the tariff model provided in the consultation document;
- Ofgem's interpretation of Article 35 is correct. The application of this article leads to a situation of 'dual regime' that could potentially be discriminatory since comparable capacities will face different tariff conditions. National Grid however provided an analysis demonstrating that price differentials between new and existing capacity contracts will have a limited and transitory impact on consumer welfare, wholesale competition and broader gas market dynamics. The Agency considers as a good practice to carry out such analysis in all market areas where Article 35 applies, as the continuation of former tariff conditions of existing contracts may induce undesirable effects on the gas market;
- The analysis provided by Ofgem together with its consultation document shows the impact of tariffs applied to interconnectors on wholesale market prices. In particular, the tariff applied at Moffat will impact the Irish wholesale gas price.
- In its consultation document, Ofgem does not provide sufficient information to ensure that costs associated to non-transmission services are charged to the beneficiaries of these services.

(4) The Agency makes the following recommendations:

- Ofgem should publish in its final decision complementary information showing that non-transmission services are charged to their beneficiaries;
- Ofgem should, jointly with the concerned NRAs, monitor the impact of the interconnectors (Moffat, IUK and BBL) tariff arrangements to avoid unintended negative impacts on the European gas market integration;

- Ofgem should monitor the impact of the ‘dual regime’ that keeps existing capacity contracts unaffected by the new RPM. If detrimental effects were to be identified, Ofgem would have to implement remedies to ensure an appropriate level of wholesale market competition.

2. Introduction

(5) While the UK has become, after 31 January 2020, a third country, the EU rules continue to apply to the UK until 31 December 2020.

(6) Commission Regulation (EU) 2017/460 of 16 March 2017 establishes a network code on harmonised transmission tariff structures for gas (NC TAR).

(7) Article 27 of the NC TAR requires the Agency to analyse the consultation documents on the reference price methodologies (RPM) for all entry-exit systems[1]. This Report presents the analysis of the Agency for the transmission system of Great Britain.

(8) On 23 December 2019, Ofgem forwarded a consultation document to the Agency proposing a RPM for the British transmission system that would be implemented as of 1 October 2020[2]. The consultation was launched on the same day and remained open until 24 February 2020. On 20 March 2020, the consultation responses and their summary were published. The Agency has taken them into consideration for this analysis. Within five months following the end of the final consultation, and pursuant to Article 27(4) of the NC TAR, Ofgem shall take and publish a motivated decision on all the items set out in Article 26(1).

(9) The process for elaborating gas transmission tariff in Great Britain is rather specific. It gives great importance to consultation with the industry: stakeholders are responsible for proposing evolutions of the transmissions tariffs, Ofgem must base its tariff decision on these proposals submitted by industry.

(10) This process started in 2015 when Ofgem issued a review of its gas transmission tariff ("Gas Transmission Charging Review"), concluding that fundamental changes were required to reflect the changing use of the transmission network, alongside implementing the then future NC TAR. Ofgem asked industry to elaborate tariff proposals. A first set of proposals was submitted in 2018 (under Uniform Network Code ("UNC") 621) but Ofgem concluded on 20 December 2018 that none of these proposals were compliant with the NC TAR.

Approach to the compliance analysis

(11) In May 2019, Ofgem received 11 new tariff proposals (UNC 678). The public consultation conducted by Ofgem concerns these 11 proposals. In the consultation document, Ofgem assessed all these proposals and concluded that only two of them comply with the NC TAR and the Regulation (EC) No. 715/2009[3]. These two compliant proposals correspond to a Capacity Weighted Distance RPM[4] and a postage stamp RPM[5], respectively. Ofgem indicated in its consultation document its preference for the postage stamp RPM, and explained that none of the 9 incompliant tariff proposals can be accepted.

(12) Consultation documents on RPM usually analysed by the Agency describe only one proposed RPM, and its comparison against the CWD RPM detailed in Article 8 of the NC TAR. Indeed, Article

[1] With the exception of Article 10(2)(b), when different RPMs may be applied by the TSOs within an entry-exit zone.

[2] The date of implementation of the new RPM and the beginning of the next regulatory period (setting the parameters of remuneration of the TSO) are not exactly simultaneous, as the next regulatory period will only start on 1 April 2021. Ofgem has not set an end date for the period of application of its RPM. It will remain in effect until it is amended or replaced in accordance with Article 27(5) of the NC TAR.

[3] https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX%3A32009R0715

[4] UNC678

[5] UNC678A

26(1)(a) of the NC TAR assumes that only one tariff proposal is to be consulted as the entity elaborating the proposal and issuing the consultation document is usually the same.

(13) To take into consideration the specificity of Ofgem's consultation in this Report:

- The Agency explains in section 4.1 of this Report why it mostly shares Ofgem's views that only the two CWD and postage stamp RPMs comply with the relevant European legislation, namely NC TAR and the Regulation (EC) No. 715/2009.
- For sake of simplicity, the Agency considers that the postage stamp RPM preferred by Ofgem is the proposed RPM within the meaning of Article 26 of the NC TAR, while the described CWD RPM is used for comparison purposes. Therefore, this document mostly focuses on the postage stamp RPM (UNC678A) described in Ofgem's consultation document and the CWD methodology is only looked at by way of comparison.

Reading guide

(14) Chapter 3 presents the analysis on completeness, namely whether all the information referred to in Article 26(1) has been published. Chapter 4 focusses on compliance, namely whether the RPM complies with the requirements set out in Article 7 of the Code, whether the criteria for setting commodity-based transmission tariffs as set out in Article 4(3) are met, whether the criteria for setting non-transmission tariffs as set out in Article 4(4) are met. The document contains two annexes, respectively on the legal framework and a list of abbreviations.

3. Completeness

3.1 Has all the information referred to in Article 26(1) been published?

(15) Article 27(2)(a) of the NC TAR requires the Agency to analyse whether all the information referred to in Article 26(1) of the NC TAR has been published.

(16) Article 26(1) of the NC TAR requires that the consultation document be published in the English language, to the extent possible. The Agency confirms that the consultation document was published in English.

(17) Overall, the information in Article 26(1) of the NC TAR has been properly published.

Table 1 Checklist information Article 26(1)

Article	Information	Published: Y/N/NA
26(1)(a)	the description of the proposed reference price methodology	Yes
26(1)(a)(i) **26(1)(a)(i)(1)** **26(1)(a)(i)(2)**	the indicative information set out in Article 30(1)(a), including: • the justification of the parameters used that are related to the technical characteristics of the system • the corresponding information on the respective values of such parameters and the assumptions applied	Yes
26(1)(a)(ii)	the value of the proposed adjustments for capacity-based transmission tariffs pursuant to Article 9	Yes
26(1)(a)(iii)	the indicative reference prices subject to consultation	Yes

26(1)(a)(iv)	the results, the components and the details of these components for the cost allocation assessments set out in Article 5	Yes
26(1)(a)(v)	the assessment of the proposed reference price methodology in accordance with Article 7	Yes
26(1)(a)(vi)	where the proposed reference price methodology is other than the capacity weighted distance reference price methodology detailed in Article 8, its comparison against the latter accompanied by the information set out in point (iii)	Yes
26(1)(b)	the indicative information set out in Article 30(1)(b)(i), (iv), (v)	Yes
26(1)(c)(i) **26(1)(c)(i)(1)** **26(1)(c)(i)(2)** **26(1)(c)(i)(3)**	where commodity-based transmission tariffs referred to in Article 4(3) are proposed • the manner in which they are set • the share of the allowed or target revenue forecasted to be recovered from such tariffs • the indicative commodity-based transmission tariffs	Not applicable
26(1)(c)(ii) **26(1)(c)(ii(1)** **26(1)(c)(ii)(2)** **26(1)(c)(ii)(3)** **26(1)(c)(ii)(4)**	where non-transmission services provided to network users are proposed: • the non-transmission service tariff methodology therefor • the share of the allowed or target revenue forecasted to be recovered from such tariffs • the manner in which the associated non-transmission services revenue is reconciled as referred to in Article 17(3) • the indicative non-transmission tariffs for non-transmission services provided to network users	Yes
26(1)(d)	the indicative information set out in Article 30(2);	Yes
26(1)(e) **26(1)(e)(i)** **26(1)(e)(ii)** **26(1)(e)(iii)** **26(1)(e)(iv)**	where the fixed payable price approach referred to in Article 24(b) is considered to be offered under a price cap regime for existing capacity: • the proposed index; • the proposed calculation and how the revenue derived from the risk premium is used • at which interconnection point(s) and for which tariff period(s) such approach is proposed • the process of offering capacity at an interconnection point where both fixed and floating payable price approaches referred to in Article 24 are proposed	Not applicable

4. Compliance

4.1 Other RPMs submitted by industry but deemed incompliant by Ofgem

(18) In its consultation document, Ofgem considers that 9 of the 11 RPMs proposed by industry do not comply with the NC TAR and the Regulation (EC) No. 715/2009.

(19) According to Ofgem, these proposals are incompliant for three main reasons:

- Some of them propose to grant short-haul discounts to some specific delivery points. Some stakeholders consider these discounts to be necessary because without them, some users might be encouraged to bypass the transmission network and build their own connection at a lower price. The Agency considers that this risk would be detrimental to the system if

it materialised, but it should not be the case if the RPM is sufficiently cost-reflective. Moreover, granting short-haul discounts weakens the logic of an entry-exit system, not allowing all network users to access the hub under the same conditions, and encourages a pricing built on a point-to-point reasoning.

- Other proposals provide for fixed-price contracts under Article 35 of the NC TAR to participate in revenue reconciliation mechanism, which would contradict the provisions of this article. The Agency shares Ofgem's reading of Article 35: contracts concluded before 6 April 2017 and containing a fixed price element at that point in time shall not be affected by the implementation of the NC TAR. It nonetheless points out that, given that a wide range of contracts are protected in this manner, this situation might induce discrimination risks and a lack of level playing field, as discussed in Section 4.2.3 of this Report.
- In one proposal, a discount is proposed to the exit point to Ireland (Moffat), based on Article 9(2) of the NC TAR. This article provides that, at entry and exit points, "*with the purpose of ending the isolation of Member States in respect of their gas transmission systems, a discount may be applied to the respective capacity-based transmission tariffs for the purposes of increasing security of supply*". The Agency is not aware of any analysis of the impact of such a discount on the security of supply in Ireland, and cannot confirm whether or not this discount is compliant. In any case, the NC TAR makes clear that such a discount is only optional. The tariff applied to the connection with Ireland will nonetheless impact the European gas market integration in the future. This issue is further discussed in Section 4.2.5 of this Report.

4.2 Does the RPM proposed by Ofgem comply with the requirements set out in Article 7?

(20) Article 27(2)(b)(1) of the NC TAR requires the Agency to analyse whether the proposed reference price methodology complies with the requirements set out in Article 7 of the NC TAR. This article refers to Article 13 of Regulation (EC) No. 715/2009 and lists a number of requirements to take into account when setting the RPM. As these overlap, the Agency will take a closer look at the five elements listed in Article 7 of the NC TAR.

(21) While respecting the principles of Article 7 of the NC TAR, Ofgem aims at transmission tariffs which reconcile different objectives, in particular:

- Cost-reflectivity;
- Promotion of effective competition, avoiding undue discrimination and cross-subsidisation;
- Network efficiency;
- Security of supply;
- Consumer welfare;
- Environmental considerations.

(22) Ofgem has selected a postage stamp RPM with floating payable capacity prices as the proposed methodology to meet these objectives. This represents a significant change from the current

transmission tariff arrangements, based on a long-run marginal cost[6] approach, with fixed capacity prices and top-up commodity charges.

(23) Ofgem considers that the current RPM based on long run marginal cost approach was adequate in the context of a growing network. In the context of network growth, that RPM provided signals relating to these additional marginal costs (additional network capacity or costs of managing a constrained system) and supported an economically efficient investment policy and enhanced competition.

(24) In its consultation document, Ofgem notes that the transmission network operates well below its maximum capacity and considers that this trend will last, since the British government adopted a legally binding target of 100% reduction of CO2 emissions by 2050. In Gas Year 2018/19, capacity prices based on long run marginal costs allowed to recover approximately 20% of the TSO's Transmission Owner allowed revenue on entry, and approximately 60% on exit[7]. Consequently, a very significant part of the TSO's allowed revenue has to be recovered through the commodity charges, and this portion would likely keep growing if the current RPM was extended.

(25) In a declining and mature network, Ofgem considers that the RPM should be based on actual costs and should primarily aim at efficiently recovering these costs rather than providing economic signals for new investments. In addition, given the meshed nature of the British gas transmission network, Ofgem does not consider distance-based signals necessary.

(26) The Agency considers that this reasoning conceptually justifies Ofgem's choice of a postage-stamp RPM.

4.2.1 Transparency

(27) **Article 7(a)** of the NC TAR requires that the RPM aim at ensuring that network users can reproduce the calculation of reference prices and their accurate forecast.

(28) The consultation document published by Ofgem is transparent and provides all the information required by the NC TAR. Given the significance of the changes between the current and the proposed RPM, Ofgem actually publishes more data than the network code requires. In particular:

- financial and capacity amounts corresponding to the grandfathered existing contracts under Article 35 are published (without revealing commercially sensitive information), which the Agency considers to be a good practice, especially where a large amount of contracts are protected by the referenced article;
- a detailed impact assessment[8] of each considered RPM was carried out by a consultant to evaluate their consequences for each category of network users.

(29) The Agency considers that the data set and the simplified tariff model published by Ofgem and National Grid allow network users to understand and reproduce the reference prices and their forecast. In addition, network users can change the input variables and input their own scenarios.

[6] The Long Run Marginal Cost methodology is an investment-based approach, which takes into account the hypothetical cost of expanding the network at each entry or exit point, plus other factors including flow scenarios and gas supply merit order.
[7] paragraph 3.3. of consultation document
[8] https://www.ofgem.gov.uk/system/files/docs/2019/12/cepa_unc678_analytical_support.pdf

(30) The Agency finds the simplified tariff model in line with the requirements of Article 30(2)(b) of the NC TAR.

4.2.2 Cost-reflectivity

(31) **Article 7(b)** of the NC TAR requires the RPM to take into account the actual costs incurred for the provision of transmission services, considering the level of complexity of the transmission network.

(32) Ofgem proposes to use a postage stamp RPM and a 50-50 entry-exit split.

(33) Ofgem does not intend to implement commodity-based transmission tariffs during the next regulatory period.

4.2.2.1 Description of the network

(34) The 7,660 km long transmission system network in Great Britain can be considered meshed.

(35) The transmission network has the following cross-border interconnection points: the Moffat IP (with Ireland) and the Bacton IP (where both interconnectors IUK and BBL connect Great Britain with Belgium and Netherlands, respectively).

(36) The transmission network is also connected to two LNG facilities (Isle of Grain and Milford Haven), to 7 storage facilities, to four on-shore production sites and to six entries from off-shore gas production facilities (beach-terminals).

(37) There are currently 232 domestic exit points, 86 of which directly connecting end-consumers to the transmission system (industrials or power stations).

4.2.2.2 Calculation of the tariffs and adjustments to the application of the RPM

(38) The proposed postage stamp RPM only uses forecasted booked capacities as a cost driver.

(39) Ofgem proposes to apply discounts of 50% to the entry to and the exit from storage facilities.

(40) The Agency finds Ofgem's approach to discounts compliant with Article 9 of NC TAR.

4.2.2.3 Comparison with capacity weighted distance methodology

(41) Ofgem and National Grid provide a very detailed tariff model allowing to compare the postage stamp reference prices with those from the counterfactual CWD methodology. Moreover, Ofgem has published, together with its public consultation document, a detailed analysis[9] assessing the respective impacts of the proposed postage stamp RPM, of the CWD counterfactual RPM and of the current tariffs, for each category of network users.

(42) The most important outcome of the comparison between the postage stamp RPM and the counterfactual CWD RPM is that, as expected, the postage stamp RPM mutes the variability of tariffs depending on the location of each point:

[9] https://www.ofgem.gov.uk/system/files/docs/2019/12/cepa_unc678_analytical_support.pdf

- Regarding the domestic entry points[10], the tariffs at beach terminals would be slightly higher under CWD (mostly located in the North and relatively more distant from the consumers) while the tariffs of other entries would be lower.
- At domestic exits, on average, tariffs faced by industrial or commercial consumers directly connected to the transmission network and by connections with DSOs would be slightly lower under a CWD RPM. On the contrary, tariffs applied to connections with power stations would be higher under a CWD RPM. However, the main difference between the two RPMs is that a CWD RPM would lead to significant variations from one point to another, depending on its geographic location: tariffs at domestic exits located in Scotland, Central and North regions (relatively closer to beach-terminals) would be lower under CWD, while the effect would be opposite for exits in the South and South-West regions and in Wales.
- At cross-border interconnection points, the CWD RPM would result in lower tariffs at the Bacton entry point, while exit tariffs at Moffat[11] would also be lower (due to the relative proximity to St Fergus and Teesside entries).

(43) The Agency understands that Ofgem considers that the use of the British transmission network will gradually decline to comply with the carbon emission targets set by the British government. Under this circumstance, TSO investment will be limited and there appears to be less need to provide locational economic signals for network efficiency and development. This justifies the choice of a postage stamp methodology.

4.2.2.4 Comparison between the tariffs for the prevailing tariff period and the tariffs for the first tariff period for which tariffs are proposed

(44) Compared to the current tariffs, the proposed RPM brings significant changes:

- the current capacity tariffs are based on long-run marginal costs, inducing relatively important differences among tariff fees depending on the location of each point;
- since long-run marginal costs do not cover the TSO's actual costs, current capacity tariffs induce significant under-recoveries that are reconciled through an important commodity charge.

(45) The Agency considers that the proposed postage stamp RPM is much more consistent with the principles of the NC TAR than the current RPM, in particular because it adopts floating capacity prices to reconcile under or over-recovery instead of setting a significant commodity charge.

(46) It is however challenging to accurately compare the proposed RPMs with the current tariffs as a full comparison requires combining the current effects of the commodity and capacity charges. Similarly with the counterfactual CWD RPM, the current RPM based on long-run marginal costs provides locational economic signals that will no longer exist with the proposed postage stamp RPM. There is an added degree of complexity: the removal of the commodity charge will affect differently users depending on their booking strategy and on the load factor of capacities.

[10] Beach-terminals, on-shore production and LNG terminals

[11] Both Bacton and Moffat IPs are technically bidirectional. However, under the Two Degree scenario considered by Ofgem, gas is supposed to flow from the continent to Great Britain and from Great Britain to Ireland.

(47) As explained in the previous section comparing the proposed RPM with the CWD counterfactual, the same type of geographical redistribution effect is observed (consumers who are relatively close to the entrances will see their prices increase, while others will see the opposite effect).

(48) In the detailed analysis published together with the consultation document[12], the consultant finds that the removal of the commodity charge will tend to slightly decrease the wholesale gas market price. Taking into account this effect, all categories of domestic consumers should benefit, on average at a national level, from the new RPM (power stations are the only category facing a negative transmission tariff impact, but, even in their case, this negative effect would be compensated by the expected lower wholesale market price).

(49) The Agency considers these changes as beneficial. Following the reasoning laid out in the previous paragraphs, the Agency concludes that the application of the proposed RPM is compliant with the principle of cost-reflectivity.

4.2.3 Cross-subsidisation and discrimination

(50) **Article 7(c)** of the NC TAR requires the RPM to ensure non-discrimination and prevent undue cross-subsidisation.

4.2.3.1 Cross-subsidisation

(51) For this analysis, the Agency defines 'cross-subsidisation' as a deviation from cost-reflectivity whereby users of the entry-exit system are charged tariffs that do not reflect the costs they cause to the system. One instrument to evaluate cross-subsidisation is the cost allocation assessment ('CAA').

(52) Ofgem calculates the CAA of its postage stamp RPM, using forecasted capacity bookings as the only cost driver. The result is below the threshold of 10% mentioned in the NC TAR (2.75% in 2020/2021). For comparison, the CAA of the counterfactual CWD RPM would be 17.1% during the same year.

(53) Ofgem performed these CAAs without taking into account the existing contracts grandfathered under Article 35 whose capacity prices will remain fixed and that are not impacted by the new RPM. It is arguably sensible to limit the scope of the CAA of the new RPM to the capacities submitted to this new RPM. It is nonetheless interesting to note that if the CAA was calculated simultaneously for the capacities submitted to the new postage stamp RPM and to the grandfathered existing contacts, the result would be 22.45%. Indeed, these existing contracts benefit from lower capacity prices and almost always concern domestic entry capacities (LNG terminal, production points or connection with storage facilities). These lower prices for domestic capacities explain the deviation in this amended version of the CAA.

(54) The Agency agrees with Ofgem's assessment that the proposed RPM does not lead to undue cross-subsidisation and does not induce excessive transfers at the expense of a specific category of network users.

[12] https://www.ofgem.gov.uk/system/files/docs/2019/12/cepa_unc678_analytical_support.pdf

4.2.3.2 Discrimination

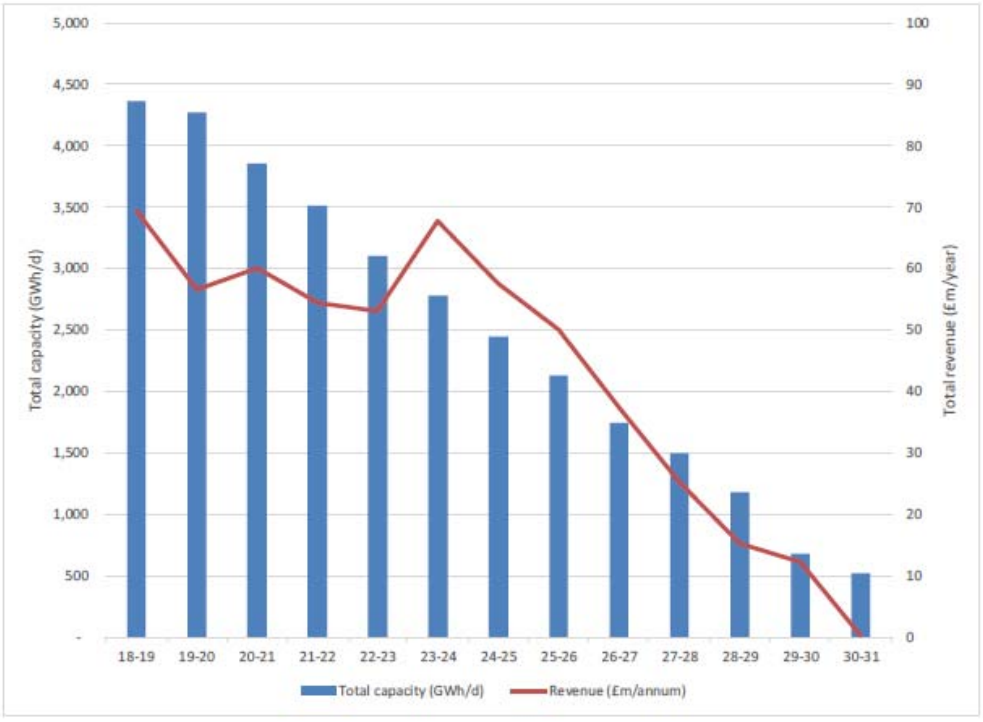
(55) For this analysis, the Agency defines 'discrimination' as 'applying different rules to comparable situations or the same rule to different situations'. The Agency has not identified any discrimination resulting from the direct application of the proposed postage stamp RPM.

(56) However, Ofgem considers that Article 35 of the NC TAR applies to several existing capacity contracts concluded before 6 April 2017. Ofgem details its legal interpretation of the Article 35 of the NC TAR in its consultations document[13]. According to this article, the proposed RPM and the revenue recovery mechanism (named revenue recovery charge by Ofgem) cannot impact the capacity prices (nor the eventual commodity charges) of these existing contacts.

(57) While the Agency shares Ofgem's reading of Article 35, this leads to a situation of 'dual regime' that could potentially be considered as discriminatory, since comparable capacities will face different tariff conditions.

(58) The NC TAR does not detail how to resolve the potential contradiction between its Article 7(c), ensuring non-discrimination, and its Article 35, grandfathering existing contracts.

(59) National Grid commissioned a consultant to produce a report[14] in order to assess the consequences of this situation. These existing contracts represent approximately 60% of the booked entry capacities in 2020-2021 (this ratio will gradually decrease to below 10% by 2031), whereas they will represent only 16% of the revenues collected at entries by the TSO. This difference of ratio suggest a significant competitive advantage for the holders of existing contracts.



Existing contract capacity and revenue recovery implications to 2030-31 (figure 0.2 of Ofgem's consultation document)

[13] paragraphs 4.17 to 4.26 of its consultation document, https://www.ofgem.gov.uk/system/files/docs/2019/12/unc678_minded_to_decision.pdf

[14] https://gasgov-mst-files.s3.eu-west-1.amazonaws.com/s3fs-public/ggf/book/2019-04/Tariff%20differentials%20between%20new%20and%20existing%20contracts%20-%20Baringa%20report.._.pdf

(60) 31 different shippers benefit from such contracts (mostly at entry connections with beach terminals, LNG terminal, and storage facilities). This number already suggest that competition could be preserved. Moreover, the analysis provided by National Grid suggests that the impact of price differentials between new and existing capacity contracts will be limited in magnitude and transitory. Three main arguments explain this:

- Entry capacities are currently relatively overbooked (and this situation is supposed to last, since Ofgem assumes a declining use of the network in its Two Degree scenario). There will likely to be a secondary market for capacity on the transmission network, where existing contract holders would have an incentive to sell excess capacity and new entrants may be able to purchase capacity at a tariff that is potentially lower than the tariff paid for existing contracts. However, it will remain necessary that existing capacity holders do not exercise any degree of market power by holding on to some unused capacity.
- The normal variation in the price of gas should by itself induce differences in wholesale costs of gas between different shippers that could compensate for the differences of capacity prices. In other words, capacity prices should not be the dominant parameter determining the merit order between gas suppliers[15].
- The tariff differential between existing and new contracts will gradually decrease. Indeed, the share of new contracts contributing the revenue recovery mechanism will gradually increase, and potential under-recoveries will be spread over a bigger amount of capacity, leading to decreasing price differentials between existing and new contracts over time. .

(61) National Grid's analysis concludes that the impacts on consumer welfare, wholesale competition and broader gas market dynamics should be limited and would not be lasting, but that some network users may face a noticeable impact in the short-term.

(62) Based on this information, the Agency considers that the application of Article 35 of NC TAR should not lead to undue discrimination between network users in Great Britain. The Agency considers as a good practice to carry out such analysis in all market areas where Article 35 applies, in order to mitigate the risks of detrimental effects on consumer welfare and market functioning.

(63) The Agency nonetheless recommends Ofgem to closely monitor the impact of this 'dual regime' in the coming years and to implement remedies if detrimental effects were such that they would significantly affect competition in a negative way. The Agency also encourages network users to flag their situation to Ofgem in case the combination of tariff and market rules works at their detriment.

4.2.4 Volume risk

(64) **Article 7(d)** of the NC TAR requires that the RPM ensures that significant volume risk related particularly to transports across an entry-exit system is not assigned to final customers within that entry-exit system.

(65) Given that cross-border flows are relatively limited in Great Britain in comparison with domestic consumption, the Agency did not identify any volume risk that might be unduly assigned to British final customers.

[15] The report provided by National Grid indicates that existing contracts would face capacity prices between £0.04/MWh and £0.41/MWh lower than new capacity bookings under the proposed postage stamp RPM.

4.2.5 Cross-border trade

(66) **Article 7(e)** of the NC TAR requires that the RPM ensures that the resulting reference prices do not distort cross-border trade.

(67) The Agency notes that in its analytical support document, the consultant identifies the Moffat IP as the marginal source of gas for Ireland. As a consequence, any changes in transmission tariffs and wholesale gas price in Great Britain are likely to be passed through to some extent to the Irish wholesale gas market price.

(68) The Agency is committed to the integration of the European gas market and encourages the concerned regulators to monitor the impact of the interconnectors (Moffat, IUK and BBL) tariff arrangements in this regard, and to consider to what extend these arrangements should be aligned.

(69) Apart from that point of vigilance, the Agency considers Ofgem's approach transparent and sensible; the proposed RPM does not induce cross-border trade distortions.

4.3 Are the criteria for setting commodity-based transmission tariffs as set out in Article 4(3) met?

(70) Ofgem proposes not to apply commodity-based transmission tariffs. The criteria for setting commodity-based transmission tariffs as set out in Article 4(3) are therefore not applicable.

4.4 Are the criteria for setting non-transmission tariffs as set out in Article 4(4) met?

(71) Article 27(2)(b)(3) of the NC TAR requires the Agency to analyse whether the criteria for setting non-transmission tariffs as set out in Article 4(4) are met.

(72) Ofgem proposes to make use of non-transmission tariffs to cover the costs of several services provided by National Grid (268 M£ in 2020/2021; for comparison, transmission revenues are expected to amount to 756 M£ the same year):

- General Non-Transmission Services Entry and Exit Charges;
- St Fergus Compression Charges;
- NTS Metering Charges;
- DN Pensions Deficit charges;
- Shared Supply Meter Point Administration charges;
- Allocation Charges at Interconnectors.

(73) Ofgem also proposes to recover costs (GBP 212 million) associated with the 'General Non-Transmission Services Entry and Exit Charges' through a flow based charge as a flat unit price for all Entry Points and Exit Points (expect connections with storage facilities).

(74) The Agency considers that the consultation document does not provide sufficient information to identify the beneficiaries of these non-transmission services and to ensure that these beneficiaries are charged the corresponding costs, as provided for in Article 4(4) of the NC TAR. Furthermore, the amounts involved are significant, as they represent more than one-quarter of the TSO's revenues.

(75) The Agency recommends that, in its final decision, Ofgem provide information allowing to check that non-transmission revenues are indeed charged to the beneficiaries of the corresponding services, or adapt them in order to ensure that this is the case.

Annex 1: Legal framework

(76) Article 27 of the NC TAR reads:

1. Upon launching the final consultation pursuant to Article 26 prior to the decision referred to in Article 27(4), the national regulatory authority or the transmission system operator(s), as decided by the national regulatory authority, shall forward the consultation documents to the Agency.

2. The Agency shall analyse the following aspects of the consultation document:
(a) whether all the information referred to in Article 26(1) has been published;
(b) whether the elements consulted on in accordance with Article 26 comply with the following requirements:
(1) whether the proposed reference price methodology complies with the requirements set out in Article 7;
(2) whether the criteria for setting commodity-based transmission tariffs as set out in Article 4(3) are met;
(3) whether the criteria for setting non-transmission tariffs as set out in Article 4(4) are met.

3. Within two months following the end of the consultation referred to in paragraph 1, the Agency shall publish and send to the national regulatory authority or transmission system operator, depending on which entity published the consultation document, and the Commission the conclusion of its analysis in accordance with paragraph 2 in English.
The Agency shall preserve the confidentiality of any commercially sensitive information.

4. Within five months following the end of the final consultation, the national regulatory authority, acting in accordance with Article 41(6)(a) of Directive 2009/73/EC, shall take and publish a motivated decision on all items set out in Article 26(1). Upon publication, the national regulatory authority shall send to the Agency and the Commission its decision.

5. The procedure consisting of the final consultation on the reference price methodology in accordance with Article 26, the decision by the national regulatory authority in accordance with paragraph 4, the calculation of tariffs on the basis of this decision, and the publication of the tariffs in accordance with Chapter VIII may be initiated as from the entry into force of this Regulation and shall be concluded no later than 31 May 2019. The requirements set out in Chapters II, III and IV shall be taken into account in this procedure. The tariffs applicable for the prevailing tariff period at 31 May 2019 will be applicable until the end thereof. This procedure shall be repeated at least every five years starting from 31 May 2019.

(77) Article 26(1) of the NC TAR reads:

1. One or more consultations shall be carried out by the national regulatory authority or the transmission system operator(s), as decided by the national regulatory authority. To the extent possible and in order to render more effective the consultation process, the consultation document should be published in the English language. The final consultation prior to the decision referred to in Article 27(4) shall comply with the requirements set out in this Article and Article 27, and shall include the following information:
(a) the description of the proposed reference price methodology as well as the following items:
(i) the indicative information set out in Article 30(1)(a), including:

(1) the justification of the parameters used that are related to the technical characteristics of the system;

(2) the corresponding information on the respective values of such parameters and the assumptions applied.

(ii) the value of the proposed adjustments for capacity-based transmission tariffs pursuant to Article 9;

(iii) the indicative reference prices subject to consultation;

(iv) the results, the components and the details of these components for the cost allocation assessments set out in Article 5;

(v) the assessment of the proposed reference price methodology in accordance with Article 7;

(vi) where the proposed reference price methodology is other than the capacity weighted distance reference price methodology detailed in Article 8, its comparison against the latter accompanied by the information set out in point (iii);

(b) the indicative information set out in Article 30(1)(b)(i), (iv), (v);

(c) the following information on transmission and non-transmission tariffs:

(i) where commodity-based transmission tariffs referred to in Article 4(3) are proposed:

(1) the manner in which they are set;

(2) the share of the allowed or target revenue forecasted to be recovered from such tariffs;

(3) the indicative commodity-based transmission tariffs;

(ii) where non-transmission services provided to network users are proposed:

(1) the non-transmission service tariff methodology therefor;

(2) the share of the allowed or target revenue forecasted to be recovered from such tariffs;

(3) the manner in which the associated non-transmission services revenue is reconciled as referred to in Article 17(3);

(4) the indicative non-transmission tariffs for non-transmission services provided to network users;

(d) the indicative information set out in Article 30(2);

(e) where the fixed payable price approach referred to in Article 24(b) is considered to be offered under a price cap regime for existing capacity:

(i) the proposed index;

(ii) the proposed calculation and how the revenue derived from the risk premium is used;

(iii) at which interconnection point(s) and for which tariff period(s) such approach is proposed;

(iv) the process of offering capacity at an interconnection point where both fixed and floating payable price approaches referred to in Article 24 are proposed.

(78) Article 7 of the NC TAR reads:

The reference price methodology shall comply with Article 13 of Regulation (EC) No 715/2009 and with the following requirements. It shall aim at:

a) enabling network users to reproduce the calculation of reference prices and their accurate forecast;

(b) taking into account the actual costs incurred for the provision of transmission services considering the level of complexity of the transmission network;

(c) ensuring non-discrimination and prevent undue cross-subsidisation including by taking into account the cost allocation assessments set out in Article 5;

(d) ensuring that significant volume risk related particularly to transports across an entry-exit system is not assigned to final customers within that entry-exit system;
(e) ensuring that the resulting reference prices do not distort cross-border trade.

(79) Article 13 of Regulation (EC) No 715/2009 reads:

1. Tariffs, or the methodologies used to calculate them, applied by the transmission system operators and approved by the regulatory authorities pursuant to Article 41(6) of Directive 2009/73/EC, as well as tariffs published pursuant to Article 32(1) of that Directive, shall be transparent, take into account the need for system integrity and its improvement and reflect the actual costs incurred, insofar as such costs correspond to those of an efficient and structurally comparable network operator and are transparent, whilst including an appropriate return on investments, and, where appropriate, taking account of the benchmarking of tariffs by the regulatory authorities. Tariffs, or the methodologies used to calculate them, shall be applied in a nondiscriminatory manner.
Member States may decide that tariffs may also be determined through market-based arrangements, such as auctions, provided that such arrangements and the revenues arising therefrom are approved by the regulatory authority.
Tariffs, or the methodologies used to calculate them, shall facilitate efficient gas trade and competition, while at the same time avoiding cross-subsidies between network users and providing incentives for investment and maintaining or creating interoperability for transmission networks.
Tariffs for network users shall be non-discriminatory and set separately for every entry point into or exit point out of the transmission system. Cost-allocation mechanisms and rate setting methodology regarding entry points and exit points shall be approved by the national regulatory authorities. By 3 September 2011, the Member States shall ensure that, after a transitional period, network charges shall not be calculated on the basis of contract paths.

2. Tariffs for network access shall neither restrict market liquidity nor distort trade across borders of different transmission systems. Where differences in tariff structures or balancing mechanisms would hamper trade across transmission systems, and notwithstanding Article 41(6) of Directive 2009/73/EC, transmission system operators shall, in close cooperation with the relevant national authorities, actively pursue convergence of tariff structures and charging principles, including in relation to balancing.

(80) Article 4(3) of the NC TAR reads:

3. The transmission services revenue shall be recovered by capacity-based transmission tariffs.
As an exception, subject to the approval of the national regulatory authority, a part of the transmission services revenue may be recovered only by the following commodity-based transmission tariffs which are set separately from each other:
(a) a flow-based charge, which shall comply with all of the following criteria:
(i) levied for the purpose of covering the costs mainly driven by the quantity of the gas flow;
(ii) calculated on the basis of forecasted or historical flows, or both, and set in such a way that it is the same at all entry points and the same at all exit points;
(iii) expressed in monetary terms or in kind.
(b) a complementary revenue recovery charge, which shall comply with all of the following criteria:
(i) levied for the purpose of managing revenue under- and over-recovery;
(ii) calculated on the basis of forecasted or historical capacity allocations and flows, or both;

(iii) applied at points other than interconnection points;
(iv) applied after the national regulatory authority has made an assessment of its cost-reflectivity and its impact on cross-subsidisation between interconnection points and points other than interconnection points.

(81) Article 4(4) of the NC TAR reads:
4. The non-transmission services revenue shall be recovered by non-transmission tariffs applicable for a given non-transmission service. Such tariffs shall be as follows:
(a) cost-reflective, non-discriminatory, objective and transparent;
(b) charged to the beneficiaries of a given non-transmission service with the aim of minimising cross-subsidisation between network users within or outside a Member State, or both.
Where according to the national regulatory authority a given non-transmission service benefits all network users, the costs for such service shall be recovered from all network users.

Annex 2: List of abbreviations

Acronym	Definition
ACER	Agency for the Cooperation of Energy Regulators
CAA	Cost Allocation Assessment
Ofgem	The British NRA, Office of Gas and Electricity Markets
CWD	Capacity Weighted Distance
EC	European Commission
EU	European Union
IP	Interconnection Point
MS	Member State
NC TAR	Network code on harmonised transmission tariff structures for gas
NRA	National Regulatory Authority
RPM	Reference Price Methodology
TSO	Transmission System Operator

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