TO Over Recovery Mechanisms

Gas TCMF 5th July 2007

Issue

- The TO Entry Commodity charge rate will be set at or close to zero as a result of the revenue implied by the 2007 AMSEC auction.
- Revenue resulting from the RMSEC auctions (and potentially Entry Capacity Trade & Transfer processes) may result in over recovery.



Buy-back Offset Over-Recovery Mechanism

- If auction implied revenue is anticipated to be more than 10% above the target TO allowable revenue, the level of the total excess revenue is divided into monthly amounts and is used to 'fund' the entry buy-back scheme.
- This is achieved by way of credits (a reduction in entry capacity charges) for each month by the lower of the monthly excess and monthly buy-back cost.
- These credits offset the costs of entry capacity buy-back that are borne by shippers through the capacity neutrality mechanism.
- Any excess amount (of over-recovery) remaining for any month is carried forward to the next month.

NTS Charging Methodology Development History

Number	Title	Background	Decision
PC65	Alternative Methods of Funding Entry Capacity Constraint Management	If auction implied revenue is more than 10% above the target TO allowable revenue, this excess is divided into monthly amounts and is used to pay a credit which offsets the capacity neutrality entry capacity buy-back costs	Not vetoed
PC66	Transportation Charge adjustment following Entry Capacity Auctions	Any under recovery would be accounted for through the generality of transportation charges rather than just the NTS Commodity charge	Not vetoed
PC67	Technical Adjustment to PC65 Mechanism	Technical adjustment that allowed the credit to be greater than the entry charges paid by an individual shipper	Not vetoed
PC75	NTS TO Commodity Charge	Introduction of an NTS TO Commodity charge (that may be negative) to supersede PC65 (compliment PC65 in final proposal)	Vetoed
PD17	Setting of NTS Transportation Charges	Consideration of whether the charging methodology is consistent with auction uncertainty	N/A
PC77	NTS TO Commodity Charge	Introduction of an NTS TO Commodity charge (that may be negative) as the primary over/under recovery mechanism with PC65/67 as the secondary mechanism	Vetoed
PC78	NTS TO Commodity Charge (NTS TO Under Recovery)	Introduction of an NTS TO commodity charge as a mechanism for dealing with the under recovery of NTS TO revenue only.	Not vetoed

PC65 & 67

- PC65 amended the transportation charging methodology such that :
 - If auction implied revenue is above, but within 10% of, the target level, there will be no automatic offsetting adjustment to transportation charges;
 - If auction implied revenue is more than 10% above the target level, National Grid NTS will calculate the level of this excess revenue;
 - The excess revenue will then be divided by six in order to establish monthly amounts;
 - For any month where the excess amount exceeds aggregate User buy-back costs, the excess amount for the following month will be increased by the amount by which the excess exceeds aggregate User buy-back costs; and
 - National Grid NTS will reduce each Users' entry capacity charges by a share of the lower of the excess or buy-back costs for the relevant month, with that share based on the proportion of aggregate MSEC held by the User concerned in the relevant month, subject to that share not exceeding its unadjusted entry charge.
- PC67 removed the rule "subject to that share not exceeding its unadjusted entry charge."

Example – Prevailing Methodology

	All figures in £millions		Oct	Nov	Dec	Jan	Feb	Mar	Total
	Excess Revenue from								
Α	AMSEC Auction Oct-Mar	A, data		· · · · · · · · · · · · · · · · · · ·					
	Initial maximum rebate								
В	level	B=A/6	£2.7	£2.7	£2.7	£2.7	£2.7	£2.7	
	RMSEC revenue for								
С	month	C, data	£0.0	£1.0	£2.0	£1.0	£2.0	£1.0	£7.0
D	Excess b/f from Apr-Sept	D, data	£16.0	-	-	-	-	-	
	Excess b/f from previous	E=J from							
Ε	month	prev. month	-	£16.7	£16.4	£0.0	£1.7	£3.4	
	Maximum rebate level	F=							
F	for month	B+C+D+E	£18.7	£20.4	£21.1	£3.7	£6.4	£7.1	£39.2
	Net buy-back cost in								
G	month	G, data	£2.0	£4.0	£25.0	£2.0	£3.0	£1.0	£37.0
н	Credit for month	H=Min(F,G)	£2.0	£4.0	£21.1	£2.0	£3.0	£1.0	£33.1
	Potential credit carried								
J	forward	J=F-H	£16.7	£16.4	£0.0	£1.7	£3.4	£6.1	£6.1*

* Contributes to the value of K in the following year

Issues

- Credits may be less than both the buy back costs and the over recovery in the period hence the process may be inefficient in redistributing excess revenue.
- The Charging Methodology is unclear as to what happens if TO revenue over recovery is triggered by the RMSEC or any other auctions that may be introduced
- Buy-back costs from earlier in the formula year but prior to over-recovery being identified might not be included
 - E.g. what if buy back costs are high in January but we do not over recover until February?

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 There is a risk that buy-back costs are less than the over recovery amount

Options Going Forward

- Trigger
 - Reset mechanism trigger to <10% or remove?
 - Linked to obligation not to over recover > 4% in any year and not to over recover > 6% over any two years
 - Process could be triggered at any point during the formula year
- Mechanism
 - The full over recovery amount could be available in the first month rather than dividing by the number of remaining months
 - The credit paid could be based on aggregate buy-back to date potentially including summer buy-back costs?
 - Initial credit could include an amount to cover any net buy-back costs incurred over the previous summer period i.e. credit could be based on aggregate net buy-back costs within the financial year.
 - Should the credit offset buy-back costs or capacity neutrality ?
 - Capacity Neutrality = buy-back (daily capacity & over-run revenue)
- Negative TO Entry Commodity charge?
 - Replacing or complimenting the buy-back offset scheme?

Proposal Step 1

- Mechanism trigger linked to obligation not to over recover > 4% in any year and not to over recover > 6% over any two years.
- Credit Calculated to off-set buy-back costs only
- The full over recovery amount available in the first month rather than dividing by the number of remaining months



Example – Proposal Step 1

	All figures in £millions		Oct	Nov	Dec	Jan	Feb	Mar	Total
	Excess Revenue from								
Α	Oct-March Auctions	A, data		I				r	£16.2
	Initial maximum rebate								
В	level	B=A	16.2						
	RMSEC revenue for								
С	month	C, data	£0.0	£1.0	£2.0	£1.0	£2.0	£1.0	£7.0
	Excess b/f from Apr-								
D	Sept	D, data	£16.0	-	-	-	-	-	
	Excess b/f from	E=J Irom							
E	previous month	prev. month	-	£30.2	£27.2	£4.2	£3.2	£2.2	
	Maximum rebate level								
F	for month	F=B+C+D+E	£32.2	£31.2	£29.2	£5.2	£5.2	£3.2	£39.2
	Buy-back cost in								
G	month	G, data	£2.0	£4.0	£25.0	£2.0	£3.0	£1.0	£37.0
н	Credit for month	H=Min(F,G)	£2.0	£4.0	£25.0	£2.0	£3.0	£1.0	£37.0
	Potential credit carried								
J	forward	J=F-H	£30.2	£27.2	£4.2	£3.2	2.2	£2.2	£2.2

Proposal Step 2

- In addition to step 1
- A credit could be paid such that the cumulative credits were calculated up to off-set the cumulative buy-back costs including buy-back from the start of the formula year
- This should increase the credits paid such that the total credits equal the buy-back costs over the relevant period (if the excess is greater than the buy-back costs).



Example – Proposal Steps 1 & 2

	All figures in £m		Oct	Nov	Dec	Jan	Feb	Mar	Total
	Excess Revenue								
Α	from Oct-March	A, data	16.2						
	RMSEC revenue								
С	for month	C, data	£0.0	£1.0	£2.0	£1.0	£2.0	£1.0	£7.0
	Excess b/f from								
D	Apr-Sept	D, data	£16.0	-	-	-	-	-	
	Excess b/f from								
F	provious month	month		£25.2	£22.2	50.0	500	50.0	
	Max robato lovel	F–	-	£20.2	£22.2	20.0	20.0	£0.0	
F	for month		£22.2	£26.2	£24.2	£1 0	£2.0	£1 0	£30.3
•	Buy-back costs in		2.52.2	£20.2	224.2	21.0	22.0	21.0	239.2
G	month	G, data	£2.0	£4.0	£25.0	£2.0	£3.0	£1.0	£37.0
	Un-credited buy-	G+G2-H from							
G2	back cost	prev month	£5.0*	£0.0	£0.0	£0.8	£1.8	£2.8	£2.8
		H =							
Н	Credit for Month	Min(F,G+G2)	£7.0	£4.0	£24.2	£1.0	£2.0	£1.0	£39.2
	Potential credit								
J	carried forward	J=F-H	25.2	£22.2	£0.0	£0.0	£0.0	£0.0	£0.0

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* £5m brought forward from summer period

Potential Charging Proposals

Trigger

- Reset mechanism to link to obligation not to over recover > 4% in any year and not to over recover > 6% over any two years
- Process would be triggered at any point during the formula year

Mechanism

- The full over recovery amount would be available in the first month
- The credit paid would be based on aggregate buy-back to date including buy-back costs from earlier in the formula year
- The credit would offset buy-back costs
 - daily capacity & over-run revenue would represent an additional credit

TO Commodity

- Consider a return to charging for the winter period only
- Consider a negative commodity rate from 2008

Summary

- These proposals would allow the credits to be maximised such that over recovery was minimised.
- NB
 - No change to National grid buy-back incentive
 - If Buy-back costs are less than over recovery then this process will still leave a residual over-recovery amount which would feed in to K for the following formula year
- A negative TO commodity charge has been proposed (and vetoed) in the past
 - Applying this approach in parallel to the buy-back offset mechanism would involve forecasting both monthly over recovery and buy-back costs

Potential Charging Methodology Proposal Timeline

Milestone	Date
Charging Methodology Proposal issued	16 th July 2007
Consultation Ends	13 th August 2007
Consultation Conclusions Report inc. Final Proposals	27 th August 2007
Ofgem veto period ends (Assumes no Impact Assessment, No notice of prices required)	24 th September 2007
Implementation	1 st October 2007

NB This is the earliest feasible timeline. A revised mechanism may not be required until later in the winter period.