30 November, 2006

Pricing Consultation Document GCM01 – Alternative Methodologies for Determination of NTS Entry and Exit Capacity Prices
Comments from the Association of Electricity Producers

The Association of Electricity Producers (AEP) is the UK trade association representing electricity generators. It has some 90 members ranging from small firms to large, well-known PLCs. Between them they represent at least 90 per cent of the transmission connected generating capacity and they embrace nearly every generating technology used in the UK. Many member companies have interests in the production and development of renewable energy where the government has set ambitious targets for development over the next decades.

The Association welcomes the opportunity to provide comments on this pricing consultation paper. We have reproduced the questions from the consultation document and provide our comments below.

Transport and Tariff Model Changes

Q1. LRMCs are calculated from either;
(a) Option 1: The Engineering model Transcost, consequentially including peak spare capacity but excluding any backhaul benefit, or;
(b) Option 2: a Transportation model of the NTS, consequentially excluding spare transmission capacity and including a backhaul benefit equal to the avoided cost of reinforcement, or;
(c) An alternative approach outlined in the Gas TCMF Progress Report GTCMF PR 01.

The Association would support option 2 as this requires less subjective assessment of settings compared with option 1. It can therefore produce repeatable results and be made available to the industry in a user-friendly manner. A transportation model would also appear to give results which may more readily be understood in terms of changes to supply / demand than the TRANSCOST model. With respect to spare capacity, we consider that the inclusion of spare capacity can give rise to unstable charges that may swing between zero and the investment cost for reinforcement. Such swings in charges would also lead to parties paying vastly different amounts overtime for the same product depending on whether there was spare capacity available at the time of purchase or not and whether or not a signal for incremental investment was required at a particular point in time. Very low capacity charges could also lead to under-recovery of allowed revenue effectively creating a cross subsidy from capacity holders at other entry points as they would have to pay a TO commodity charge as well as the capacity charge. This does not seem to be a sensible way to set charges to recover the cost of long–lived assets, hence it would be more pragmatic to exclude spare capacity.

Q2. NTS Capacity Prices are determined from either;
(a) Option 1: a ten year Supply & Demand forecast using the current Gas Year's Base Case data and network model, or;
(b) Option 2: a single year Supply & Demand forecast using the relevant Gas Year's Base Case data and network model for the capacity released.

The Association would support the use of a single year supply / demand model as this most closely reflects the network in the year in which the charges will apply, and are more likely to be cost reflective of that network. It also avoids the need to use forecasts of supply / demand further into the future which will inevitably be less accurate. The averaging effects of a multi year model will also dilute temporal price signals.

Q3. Baseline Entry capacity prices are determined either;
(a) Option 1: using a single analysis of the Base Case scenario adjusted to the 1-in-20 demand level, or;
(b) Option 2: from the TYS base case scenario, with Entry point specific analysis, such that each NTS Entry Point was at the relevant supply level and a supply/demand balance achieved via supply substitution.

The Association would support option 2 otherwise the charges could be too sensitive to assumptions on where supply is coming – this may in turn lead to less stability and predictability of charges. We consider that more stable and predictable charges are consistent with promoting competition. However we also recognise that the adoption of option 2 will make the charging model less user friendly as it will have to be run a number of times with different supply numbers to create entry charges.

Q4. Views are invited as to whether the relevant supply level referred to in Q3, used to determine Baseline Entry Capacity prices, should be either;
a) Option 2a: the Base Case supply (capped at the baseline/obligated capacity level) at each NTS Entry Point (this will therefore be equal to or less than the obligated NTS SO Baseline Entry Capacity level as defined by National Grid's NTS Licence), or;
b) Option 2b: the obligated NTS SO Baseline Entry Capacity level, as defined by National Grid's NTS Licence, at each NTS Entry Point.

We consider that this question is really seeking views on the likelihood of asset stranding vs the socialisation of spare capacity costs via an increased TO commodity charge to be paid by all and whether this creates a cross subsidy.

The use of the obligated baseline for determination of charges is consistent with the network that NG must provide it would also provide for more stable charges than a base case supply model. However it would set charges at a higher level, at declining terminals, than if the base case supply was used. This would mean that the charges were more effectively 'use of system' charges based on the pipes already installed. It would also mean that any TO commodity charge would be lower (for a given level of bookings) than if the Base Case supply model was used.

The use of a Base Case supply model would give rise to lower charges at declining terminals but if this did not lead to increased booking would require the revenue differential to be raised via a higher TO commodity charge. This would effectively

mean that all users of entry capacity would be funding / or subsidising the spare capacity at certain terminals. There may also be cross subsidies created where users have committed to capacity purchases long term at higher prices prior to the introduction of the lower charges. The use of a Base Case supply model would also introduce a degree of subjectivity as there would be decisions to be made over where the gas is supplied, whereas the baseline option would be based on published baseline values.

We consider that asset stranding is unlikely to be reduced simply because capacity charges are slightly lower, this is because we would expect any new fields or incremental supply would utilise existing offshore infrastructure which should also develop spare capacity as existing filed decline. We also consider that it would not be desirable to increase the TO commodity charge further as this leads to poor cost targeting. We would therefore support the use of baselines (option 2b) in determining entry capacity charges.

Q5. Incremental Entry Capacity prices are determined either;
(a) Option 1: the prevailing methodology, or;
(b) Option 2: using the TYS Base Case scenario, from a series of Entry Point specific analyses with the relevant NTS Entry Point adjusted to the obligated capacity plus step increment level and a supply/demand balance achieved via supply substitution.

If a transportation model is adopted option 2 would provide a consistent approach to the setting of reserve prices and incremental prices.

Q6. Entry and Exit LRMCs be calculated from either;
(a) Option 1: route costs disaggregated into Entry and Exit costs using the Excel Solver such that in aggregate 50% of route costs are targeted at NTS Entry Points and 50% of costs at NTS Exit Points (the average positive values of the entry LRMCs equals the average positive values of the exit LRMCs), or;
(b) Option 2: the cost from a "reference node" to each relevant offtake point and the cost from each entry point to the "reference node" and that the LRMCs is adjusted to give a 50:50 split between average positive value of these adjusted Entry & Exit costs, or;
(c) the prevailing methodology.

The Association considers that Option 2 is consistent with a transportation model approach and that the choice of reference node is immaterial if the entry / exit split is adjusted to 50:50 at a later stage.

Q7. LRMCs are converted into prices using the annuitisation factor set out in National Grid's NTS Transportation Licence.

We support this approach

Q8. The raw Exit Prices are adjusted such that the positive values can be used to set prices to recover allowed revenue and that the negative prices are removed as part of the adjustment step.

We support the use of adjustment of raw exit prices, by the addition of a constant factor, to recover allowed revenue. Also the removal of negative prices, as these only really have any meaning if they could be coupled with a 'must flow' obligation which would add unwarranted complexity.

Q9. No year-on-year capping of NTS Exit Capacity prices is included in the methodology.

We support the removal of year-on-year capping in principle as we recognise this can constrain the cost reflectivity of charges. However it is important that charging 'shocks' are avoided. The publication of indicative charges with commentary on the reasons for variations from the previously published indicative charges should help to avoid this.

Implementation

Q10. The combined Transport and Tariff model used by National Grid NTS to determine NTS Capacity Prices, be made publicly available.

The Association supports the publication of the combined transportation and tariff model. This will provide greater transparency of process and enable users to model their own scenarios.

Q11. The Incremental Entry Capacity price determination methodology is included within the Gas Transmission Transportation Charging Methodology.

It would seem more logical to include this in the charging methodology statement than the IECR.

Q12. This proposal is implemented for price determination in relation to all exit capacity from 1st April 2007 to 30th September 2010

The Association would support implementation from April 2007 provided the appropriate notice periods are maintained. We would not support end dating of the methodology as a principle this creates uncertainty and could lead to changes being rushed through to meet a deadline. Rather the methodology should persist until changed. Hence any changes to the methodology effective from October 2010 could be progressed during 2007 and certainly should be progressed prior to the initialisation of the enduring regime, if implemented. Any such changes could simply have an implementation date of October 2010.

Q13. This proposal (NTS GCM 01) is implemented for price determination in relation to all entry capacity auctioned from 1st April 2007.

The Association would support this, it would seem sensible to implement new approaches to charging at the same at entry and exit, to avoid and inconsistencies that could otherwise arise.