

Jan Gascoigne  
Regulatory Frameworks  
National Grid  
National Grid House  
Gallows Hill  
Warwick CV34 6DA

Your ref NTS GCM01  
Our ref  
Name Charles Ruffell  
Phone 01793 89 39 83  
Fax 01793 89 29 81  
E-Mail charles.ruffell@rwenpower.com

30<sup>th</sup> November, 2006

**NTS GCM01: Alternative Methodologies for Determination of NTS Entry and Exit Capacity Prices  
November 2006**

Dear Jan,

We welcome the opportunity to comment on the issues raised in this consultation document. This response reflects the views of RWE npower and the UK based business of RWE Trading GmbH.

**General Comments**

This consultation sets out options for revising the National Grid NTS (NG NTS) gas transmission transportation charging methodology, which have been considered at the Gas Transmission Charging Methodology Forum (GTCMF).

It is clear that the pattern of flows onto and off the NTS has changed significantly since the charging methodology and associated models were initially developed. Exit capacity prices have not been rebalanced since 2001 and this had led to a divergence between current tariffs and LRMCs. In addition, there is a desire to decouple entry capacity reserve prices from entry UCAs, such that they can be set more dynamically. We welcome NG NTS facilitating the opportunity to debate these issues.

In considering the alternatives presented, we recognise that the charging arrangements must satisfy the relevant charging objectives under the National Grid NTS GT Licence and the EU Gas Regulations. In addition, the methodologies will need to ensure that the practical application of the high-level charging principles meet the requirements of network users and suppliers, which include predictability and minimising unexpected price changes. Meeting these may require a trade-off between a number of the objectives.

RWE npower

Trigonos  
Windmill Hill  
Business Park  
Whitehill Way  
Swindon  
Wiltshire SN5  
6PB

T  
+44(0)1793/8  
9 39 83

F  
+44(0)1793/8  
9 29 81

I  
www.rwenpowe  
r.com

Registered  
office:  
RWE Energy plc

## Questions for Consultation

The consultation raises a number of detailed questions and our responses are set out below:

**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.**

We recognise that the treatment of spare capacity in the derivation of LRMCs is the key issue to be resolved here. Spare capacity arises due to under-utilisation of assets at declining entry points. Although including spare capacity would set a reserve price that provided a locational signal in one long-term auction at declining ASEPs, its transient nature could lead to significantly much higher reserve prices in subsequent years. Furthermore, it is not clear to us whether producers could respond to these locational signals, as new gas fields may not have much flexibility over their choice of beach terminal, although there could be an effect for marginal supplies from existing fields. On this basis we believe that including spare capacity will:

- (a) Create windfall gains and losses depending on the timing of shipper participation in long-term entry capacity auctions;
- (b) Introduce significant volatility in reserve prices as spare capacity becomes utilised and new investment is triggered;
- (c) Lead to an under-recovery of allowed revenue as capacity holders would be paying very low prices for capacity that did not reflect underlying long-run costs nor the actual assets being used; and
- (d) Require a commodity-based mechanism to recover any shortfall which we believe undermines the incentives provided by the current capacity:commodity split.

Turning to the models themselves, we can see benefit in releasing a simpler charging model that improves transparency, allows users to undertake scenario analysis and improves charge stability. We believe that these benefits outweigh any possible inefficiency arising from ignoring spare capacity and on balance, therefore, we support **Option 2**.

**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.**

Consistent with our answer to Question 1, we support **Option 2**.

**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.**

Investment costs on the network will be driven by peak flows, so we support **Option 1**.

**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.**

This appears to be a choice over the extent to which costs are socialised. Under Option 2a, there is the possibility that the base case supply model flows will lead to an under-recovery at some declining ASEPs as charges will be below those necessary to recover required revenue. Using baseline capacities as proposed under Option 2b will set higher charges than those under 2a at declining terminals. This means that the costs of providing assets at those ASEPs is targeted on users of those assets, with less of any under-recovery needing to be smeared back across all users than under Option 2a. This is an analogous argument to that made under Question 1 and we therefore support **Option 2b**.

**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.**

We support **Option 2** as it appears to be more consistent with an approach based on a Transportation model.

**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.**

Consistent with our answer to Question 1, we support **Option 2**.

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

We agree with this proposal.

**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.**

As there is no concept of negative prices, we agree that they should be removed. Their removal should be at a stage in the adjustment process that preserves locational signals at exit.

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

We agree that year-on-year capping should be removed. We offer support on the basis that it will improve cost reflectivity of the prices and also the Transportation model methodology together with availability of the model will improve transparency and predictability of the price setting process.

**Implementation**

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

Subject to resolution of confidentiality issues, we support release of the combined Transport and Tariff Model.

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

Agree.

**Q12. This proposal is implemented for price determination in relation to all exit capacity from 1st April 2007 to 30th September 2010. Q13. This proposal (NTS GCM 01) is implemented for price determination in relation to all entry capacity auctioned from 1st April 2007.**

We have concerns about the relatively short timescales to implement these changes by April 2007 but in principle we agree that it is sensible to implement the new arrangements at the same time for the derivation of both entry and exit prices.

We hope these views are helpful and if you wish to discuss them further please contact Steve Rose on 01793 892068 or myself on 01793 893983.

Yours sincerely,

Charles Ruffell  
Economic Regulation