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By Email to:
Chris Logue, National Grid Gas
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Dear Chris,

RWE's Response to National Grid Transmission's Consultation on Entry Capacity Release Methodology Statement

RWE welcomes the opportunity to respond to this consultation and we were pleased that this topic was presented for discussion at industry meetings and webinars both before and after the consultation was released.

We think the approach to determining capacity released at Milford Haven is important to ensure that GB remains a competitive destination for gas and keep downward pressure on costs for consumers. However, National Grid appear to have only conducted a basic analysis (about which we have concerns) of the cost of the current arrangements, and have not presented the alternative costs of the proposal.

Therefore, we believe it will be important to now allow for a comprehensive and robust impact assessment which carefully considers resulting transaction costs and volumes of gas that are likely to be impacted under the current and proposed arrangements to understand the short term cost implications.

We also have concerns that continuing to change the level of obligated capacity is not in line with the principles of UNC market arrangements and will therefore have implications for investor confidence in the medium to long term.

In our full response in Annex 1 below, we map out some of the market fundamentals that could be considered in an impact assessment and that illustrate why the proposed arrangements might not be the best solution for reducing costs to consumers. We also have some alternative suggestions to the approach to capacity release.

If you have any comments or wish to discuss the issues raised in this letter, then please do not hesitate to contact me.

Yours sincerely,
By email

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Annex 1

RWE's Response to National Grid Transmission's Consultation on the Entry Capacity Release Methodology Statement

1. A comprehensive and robust impact assessment is needed for such a significant change.

In our response to National Grid's Milford Haven Summer 2023 Questionnaire issued in September 2022, we stated our view that managing constraints by reducing the amount of capacity released is probably suboptimal. We also said that National Grid needed to publish a full cost-benefit analysis with clearly documented assumptions for all alternative options and scenarios. Hence, we were disappointed in the lack of analysis to support the proposed reduced baseline levels in the December 2022 ECR Consultation Letter. We have mapped out our view of the possible fundamental cost drivers in Sections 4 and 5 below, which illustrate that National Grid's ECR proposal might be more costly for consumers than the current arrangements. We think a comprehensive and robust impact assessment is needed, with carefully considered prices and volumes to quantify these costs, given that this is such a significant proposed change.

2. A change to the amount of obligated capacity that is released will reduce investor confidence

Even if a more thorough impact assessment concludes that it is more cost optimal in the short term to reduce the amount of obligated capacity, we think changing the arrangements could be damaging for investor confidence, having implications for the consumer in the medium to long term.

National Grid and Ofgem took a decision to manage baseline capacities with commercial tools rather than build additional transmission capability. We think that this may have been the right decision at the time, but we don't agree that the contract with Users should be changed as soon as and if this decision is shown to be dis-optimal for consumers. Industry cannot tear up contracts that become onerous. Users have invested in infrastructure and entered into option contracts based on their confidence of the obligated capacity that will be released at Milford Haven and a reduced baseline level will reduce the value of these investments.

This proposed change to baseline capacities sets a precedent for future costs and liabilities arising from the Uniform Network Code, and we are now concerned that other arrangements could be subject to change where National Grid and Ofgem deem that the contract is onerous and "out of the money" for consumers.

3. National Grid is not best placed to carry out an assessment of the severity of constraints costs or the impact of their proposal on its own

Having stated that National Grid needed to conduct a full cost benefit analysis, we now realise that it is not best placed to carry out the analysis to compare the potential costs of constraints versus the impact on wholesale gas prices if LNG cargoes are deterred from delivering to GB. The market fundamentals and hence

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costs of these different solutions are dependent on the costs incurred by Shippers as a result of needing to reschedule or cancel injections at the Entry Point and on the cost of replacing gas from alternative sources. This analysis requires data and knowledge from market activity outside of National Grid's operations.

4. The problems with National Grid's analysis presented in the proposal

Our main concern with the analysis in the ECR proposal is that the estimated costs to the consumer are limited to the cost of using of commercial tools to manage constraints under current arrangements, presumably because it is only these costs which would be visible and impact National Grid directly. There is no estimate of the alternative risk of of increased wholesale market prices resulting from the need to replace LNG cargoes unnecessarily deterred from GB with more expensive alternatives.

The different costs and volumes impacted need to be weighed up between the current arrangements and the proposal. We think that the current arrangements will result in a lower volume of constraints than the volume of LNG that would be deterred as a result of implementing this proposal. We also think that the price of replacing the deterred LNG could be much higher than the price of locational trades.

We also have serious concerns with the analysis that has been undertaken to estimate the potential cost of constraints. At an industry webinar on 21 December 2022, National Grid presented slides with further detail on their constraints costs analysis. A snapshot from the slides is shown in Figure 1.

In particular, we do not understand why National Grid have calculated the cost of locational trades by selling more gas than is bought back to maintain integrity of the system. This does not seem to be a correct approach to isolating the costs of constraint management.

We also think that the transaction price assumptions in the proposal are very pessimistic. Following the meeting on 21 December, we now understand that historic data has been used to derive multipliers on the wholesale price to estimate the price of buybacks and locational trades. Ofgem states in the Wormington Compressor Emissions Final Preferred Option Consultation issued on 5 December 2022, that "*Buy back actions were last used in July 2006*" and "*Over the past 12 years there have been 34 locational balancing actions at the Milford Haven system entry point*". We surmise that it must be these transactions that were used to derive the locational trade and buyback prices in the ECR proposal consultation. We question whether these prices are representative, given that all of these transactions will have taken place before the Ukraine invasion and at a time with very different market fundamentals and at much lower prices. The estimated cost of buy back actions is particularly concerning given that it appears they are derived from transactions from 15 years ago.

In the case of Entry Capacity buybacks from LNG importers, we agree with Ofgem in the Wormington Consultation that "*the cost of capacity buy back, and locational balancing action should be roughly similar*". It appears that Ofgem's conclusion that buybacks are more costly is because they typically are executed in larger volumes than locational trades, not that the price is greater. Therefore the ECR consultation price assumptions, where buybacks are priced much more highly than locational trades, do not appear to be consistent or correct.

We also note that in the Wormington Consultation, Ofgem has concluded that it is not appropriate to assume that constraints will be managed with the proportion split equally between buybacks and locational trades, and that a much larger proportion is likely to be executed in locational trades. Therefore it follows that this should also be the case for the analysis in this proposal.

4.1 A more realistic approach to the pricing of constraints costs

As we understand it, the main constraint on the NTS causing the capability restriction at Milford Haven is actually at Churchover in Warwickshire. Therefore, the capability at Milford Haven is variable day to day because it is a function of the Churchover capability minus the offtake upstream of this point i.e. in South Wales and West Midlands. This means that the capability at Milford Haven will be lower and constraints more likely to bite when demand is low. It follows that the probability of constraints is probably negatively correlated with wholesale gas market prices, i.e. are more likely to occur when gas prices are low, not high.

A locational sell trade to alleviate constraints is likely to be sale from National Grid to LNG importers at Milford Haven to reduce their entry flows on a particular day when constraints are biting. LNG importers would then need to defer their gas injections to a later date and sell this gas in the next highest priced NBP period for which the NTS capacity is available. This would require there to be spare LNG storage in the meantime (please note that it could likely happen that no LNG storage is accessible for the shippers). This selling pressure would actually decrease NBP prices during this alternative later delivery period. However, if there was insufficient storage to accommodate this constrained gas, further costs could be incurred such as demurrage on cargoes for which discharge becomes delayed or as a consequence of rerouting cargoes at short notice. We think an impact assessment should consider how much spare LNG storage capacity might be available and the extent to which injections could simply be rescheduled before more costly alternative arrangements need to be made. This will be important to establish appropriate locational trades and buyback prices.

Alternatively, a locational sell trade could be executed at Pembroke Power Station if it was not already generating at maximum output because power demand was low and therefore margins were negative. We would expect this gas to be priced based on the level at which the generator could sell the power produced from it. This selling pressure would probably decrease power prices.

Although locational sell prices would be determined by the value of gas to a limited number of counterparties, the replacement gas on the other side of the constraint would be from the rest of the market. This means that locational buy trades should probably be priced at NBP, and we do not think there would be any significant additional cost associated with this particular transaction.

Hence we would expect the price differential between locational buys and sells to be based on gas time spreads (that reflect the deferral period of gas injection to the NTS) or gas to power spreads that reflect negative power generation margins during low demand, low priced periods.

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4.2 Properly assessing the volume of Constraints Costs

The analysis assumes that under current arrangements there is a potential for capacity procurement and nominations of gas to the current maximum released level of 87mcm, and that this could happen every day throughout the summer. We think that this is unlikely to be a credible scenario, because it is very unlikely that the level of GB demand in the summer and capacity of the interconnectors would support these levels of LNG demand unless other sources of supply were severely disrupted.

It is our expectation that at such a high level of LNG availability and low level of demand, the market would become self-correcting to some degree and prices would fall to the extent that they would probably not attract further LNG imports. Major sources of supply would probably have to be missing to sustain such a high level of LNG demand.

We think it will be important to establish in the impact assessment the maximum feasible and most likely levels of capacity demand at Milford Haven to understand what volumes might realistically need to be curtailed.

Capability	65	mcm	715,000,000	kWh
Flow	87	mcm	957,000,000	kWh
Constrained volume	22	mcm	242,000,000	kWh
Gas price	350	p/th	11.9425	p/kWh
Locational sell	266	p/th	9.0763	p/kWh
Locational buy	479.5	p/th	16.3612	p/kWh
Buy Back	525	p/th	17.9137	p/kWh
	50% Locational Sell		10,982,322	£ revenue
	25% Locational Buy		9,898,540	£ cost
	50% Buy Back		21,675,635	£ cost
	Day 1 net cost		20,591,853	£ cost

Figure 1 - Constraint Management Cost Assumptions

5. The Missing Counterfactual

5.1 Impact on Wholesale Market Prices

A very important point to note is that any gas that cannot be delivered due to constraints will almost certainly have already been sold into the wholesale market and this will have previously put a downward pressure on prices. The buying pressure as a result of needing to replace gas subject to constraints might increase gas prices, but this can be seen as a price correction. The net amount of gas that has been delivered to the market is zero – it has been sold and is subsequently bought back.

On the other hand, if LNG cargoes aren't delivered to GB and were unnecessarily deterred, there would obviously not have been any previous sale of this gas. This gas will still need to be replaced by an alternative source and the market is net shorter than it would have otherwise been. This will only put upwards pressure on gas prices. The difference between the cost of this alternative source of gas and LNG imports might be higher than the difference between locational buys and sells.

5.2 Possible impact on LNG supply volumes

We note that National Grid have highlighted in the ECR consultation letter that despite high exports of gas to Europe throughout Summer 2022, Milford Haven flows were significantly below the restricted level of capacity. However, this is because LNG importers who did not already hold NTS entry capacity chose not to import.

Constraints costs are obviously only incurred when they actually bite, whereas LNG cargoes are deterred as soon as importers perceive a risk of not being able to procure capacity. The latter could obviously occur even if constraints are not biting. We think understanding the amount of "headroom" required before LNG importers perceive a risk that they might not be able to procure capacity could be useful in quantifying an appropriate baseline level to minimise costs to the consumer.

In particular, the reduction in capacity released last summer already made some LNG importers decide not to deliver LNG cargoes to Milford Haven. Instead they were delivered to other locations in continental Europe, since the risk of not being able to find capacity to flow the re-gasified LNG to the grid was simply too high. This reduction in the amount of LNG supplied to the UK already made UK consumers pay a higher price for their gas.

If Summer 2022 arrangements are shown to have been unnecessary because the LNG that would have been imported under the unrestricted baseline would not have exceeded capability levels, then the most optimal arrangements for this summer would have been to retain the baseline at 87mcm.

The market fundamentals for Summer 2023 are very different. We think a comprehensive impact assessment considering the impact on prices and volumes this coming summer needs to be carried out to identify the capacity release arrangements that result in lowest cost for consumers.

6. Other arrangements for consideration

If obligated capacity is to be reduced, we think the proposal could be improved by considering breaking down obligated capacity into weekly periods and considering releasing additional weekly capacity when the monthly auctions take place rather than fixing the whole month at a maximum monthly median. This will probably enable National Grid to release more capacity during those weeks when capability is forecast to be higher, and will enable Users to book capacity that more closely matches their requirements i.e. so that capacity that is not needed across the whole month will remain available to other Users.

We would also urge National Grid to consider releasing the full baseline capacity of 87mcm for the monthly auctions for May. Should capacity end up being very tight for May, we envisage that deferrals might be made until June whilst June remains unsold, and will enable National Grid to trial releasing full capacity levels.

We would also recommend committing to offer alternative capacity to Users who execute locational trades or buybacks with National Grid at Milford Haven to give them confidence they will be able to reschedule gas injections that have been subject to those trades. We would expect any constraints in May to cause LNG importers to defer their injections to the NBP and therefore securing capacity at a later date would reduce capacity procurement risk for them and hence might reduce the cost of locational trades.