

## Representation - Draft Modification Report 0517/A/B

### 0517 - Review of the Supply Matching Merit Order in Setting Capacity Charges

### 0517A - Review of the Supply Matching Merit Order in Setting Capacity Charges and Timing of Resultant Price Changes

### 0517B - Review of the Supply Matching Merit Order in Setting Capacity Charges, Rolling Average to Reduce Volatility in Annual Charges

Responses invited by: **24 July 2015**

<b>Representative:</b>	John Costa
<b>Organisation:</b>	EDF Energy
<b>Date of Representation:</b>	24 <sup>th</sup> July 2015
<b>Support or oppose implementation?</b>	0517 - Support 0517A - Support 0517B - Oppose
<b>Alternate preference:</b>	<i>If either 0517, 0517A or 0517B were to be implemented, which would be your preference?</i>  0571A
<b>Relevant Objective:</b>	a) Positive  aa) Positive  b) Positive  c) Positive  d) None*

**Reason for support/opposition: Please summarise (in one paragraph) the key reason(s)**

The original proposal 517 seeks to amend the merit order used in the Transportation model to ensure the UNC better reflects how supplies are currently utilised in setting transportation charges. The current merit order was set in 2009 and was based on the likely supply assumptions at the time. It basically states what supplies are used from different sources (beach, interconnection, Long-range storage, LNG, Mid-Range Storage (MRS) and short-range storage) to meet demand on a peak 1 in 20 day in the Transportation model. Grid's analysis shows that MRS is not being utilised in the model

as peak day supplies meets demand at the LNG point in the stack and therefore does not contribute to the calculation of charges, even though the analysis presented conclusively shows that MRS has historically and is likely to flow on such a day. This problem is further exacerbated with peak demand levels decreasing each year (11% in the latest Winter Outlook Report).

There is evidence to show that the 2009 stack is out of date and this proposal proposes to combine MRS and LNG into one group within the merit order and prorate supplies equally from each to achieve the supply and demand match required. The two alternatives 517a and 517b raised by Wales & West and SSE respectively propose the same changes to the merit order but with different methods of smoothing the implementation so that the effect on charges and revenue collection by DNs can be minimised, particularly in Wales, South West, South and South East networks where the impacts are greatest.

Given that the analysis presented shows MRS supplies have and are likely to flow on peak high priced days (indeed its share has been increasing in recent years) it sounds intuitively wrong if the merit order is not reflective of the actual contribution of MRS to the system on peak days. This has led to Exit capacity charges close to MRS points being higher given that gas has to flow across more of the network to supply those customers. Correcting this by placing MRS at the same level in the supply merit order with LNG should lead to more balanced and cost reflective charges across users of the system. One could argue that it may not be the right place in the stack (it could be merged with Long-Range Storage for example if, as some believe that LNG will be the marginal source of gas on a 1 in 20 peak demand day) however it's a step forward in achieving more cost reflective charges.

We therefore agree that promoting MRS to the same level as LNG supplies and prorating them equally to meet forecast demand better reflects the likely 1 in 20 peak day supply utilisation and further facilitates the following Relevant Objectives A) results in charges that reflect the costs incurred by the licensee in its transportation business, aa.(l) best calculated to promote efficiency and avoid undue preference in the supply of transportation services, B) the charging methodology properly takes account of developments in the transportation business and C) facilitates effective competition between gas shippers and gas suppliers. We agree with the Draft Mod Report that relative objectives d) Decisions made by Secretary of state and e) EU regulations are not relevant here.

We understand that this change will create some large changes in some parts of the network, particularly those close to LNG facilities. Wales & West alternative 517a proposes a two year delay to implementation due to the cash flow problems it creates (DN's have to pay NTS charges immediately but have to wait two years before increasing charges to customers) and to reduce volatility. We do not believe 517 introduces more volatility; it is just a one off step change which can not be argued to be the same as volatility. However it is a relevant point as there is a balance to be struck between attaining cost reflective and stable charges. We therefore see merit in Wales & West's alternative 517a to allow time for implementation and to minimise higher charges in two year's time to claw back the costs from the cash flow problems 517 would introduce. For these reasons we believe 517a better facilitates the relevant objectives over 517.

517b proposes to soften the impact by averaging prices over the last three years using a simple arithmetic average. However, this will artificially dampen NTS charges and create larger variances in under recoveries which will be picked up under the TO commodity charges as the Draft Modification Report (DMR) states. We believe this modification will lead to less cost-reflective prices and more uncertainty and volatility in the charges Users will actually face going forward. We do not believe 517b therefore furthers any of the relevant objectives.

**Implementation:** *What lead-time do you wish to see prior to implementation and why?*

Given the large changes in charges this modification would introduce in some parts of the network, we believe that sufficient time should be allowed for Users to be able to digest and implement them in their internal processes and customer bills. With this in mind we agree with the timelines set out for 517a in section 5 of the draft modification report.

**Impacts and Costs:** *What analysis, development and ongoing costs would you face?*

The costs of implementing these changes would be no different to the normal Transportation changes issued throughout the year.

**Legal Text:** *Are you satisfied that the legal text will deliver the intent of the Solution?*

None

**Are there any errors or omissions in this Modification Report that you think should be taken into account?** *Include details of any impacts/costs to your organisation that are directly related to this.*

More information on the supply merit order make up, the economic cost assumptions behind it and where the peak 1 in 20 demand level bites would have been useful to support why the modification is needed. The analysis used in the DMR was more about actual flows on recent highest demand days which is not the same thing as the assumptions behind the 1 in 20 Peak day stack in the merit order, although we recognise they do provide some level of indication.

We also agree with the workgroup's views that the Transportation model could be reviewed more generally to see if it is as up-to-date and robust as possible given the changes in supply and demand patterns particularly in a low carbon economy where the network will generally not get any bigger.

**Please provide below any additional analysis or information to support your representation**

N/A