

## 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>	Vineet Arora
<b>Organisation:</b>	Noble Clean Fuels Limited
<b>Date of Representation:</b>	23/07/15
<b>Support or oppose implementation?</b>	0517 - Support 0517A - Qualified Support 0517B - Oppose
<b>Alternate preference:</b>	<i>If either 0517, 0517A or 0517B were to be implemented, which would be your preference?</i>  0517
<b>Relevant Objective:</b>	<b>a)</b> Positive for 0517 and 0517A, Negative for 0517B <b>aa)</b> Positive for 0517 and 0517A, Negative for 0517B <b>b)</b> Positive for 0517 and 0517A, Negative for 0517B <b>c)</b> Positive for 0517 and 0517A, Negative for 0517B <b>d)</b> None

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

The analysis performed by National Grid, coupled with an understanding of the interactions between LNG supplies and MRS storage with demand, show, conclusively, that the existing Supply Merit Order introduced in 2009 is not fit for purpose. The existing Merit Order was implemented without any experience of how LNG supplies would evolve, and seemingly was based on little more than an expectation of how supplies would be structured on a peak day. With experience it is clear that LNG supplies are “patchy” and subject to a rapidly developing global LNG market. Certainly,

even without the evidence produced by NGG, it would be more pragmatic to assume that embedded, national MRS storage would compete with LNG to supply gas to the GB market on a peak day, noting that GB gas prices are highly correlated with demand ( we would also note that storage flows exhibit a more positive correlation with demand, than do LNG flows)<sup>1</sup>. The proposed solution in mod 0517 maintains the LRMC methodology which underpins GB transmission charges, while at the same time provides “equal weighting” to LNG and MRS supplies. It does not promote MRS supplies above LNG, which is a sensible, incremental evolution to the established merit order

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

Implementation should be 1<sup>st</sup> October 2016. Lead times should allow for sufficient notice to be given as required in NGG’s Licence.

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

None

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

Yes

**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.*

No

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

All three proposals recognise that the merit order is outdated and in need of modification. Certainly, this should be seen as a strong statement of broad industry support that the analysis and arguments presented during discussions are suitably robust to further a change. Both modification 0517 and 0517A implement the merit order change in accordance with the established charging methodology i.e. that marginal costs are used to determine User charges. Modification 0517B, we would argue, represents a departure from the accepted methodology, through the application of averaging. In our opinion, this was be a retrograde step, leading to a dilution in cost reflective charging and, by extension, will lead to cross-subsidisation between Users and across charging years.

NCFL is surprised that modification 0517B was granted alternative status as it goes beyond the scope of the original 0517. Admittedly, it does seek to modify the merit order, in line with the other two modifications, but the application of average charges is inconsistent with the principles underpinning the GB gas transmission charging regime and as a result should be dismissed. Of course, if it is believed that the fundamentals of

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<sup>1</sup> See Waters Wye Associates report for GSOG “UK Transmission System benefits from storage”, April 2014

the charging regime are not fit for purpose then it is within the gift of the industry to initiate a more thorough root and branch review. The application of average charges would be more appropriately considered in such a review.

Finally, although we have sympathy with modification 0517A we find little evidence for its implementation. The continuation of a merit order which appears inconsistent with market reality should not be countenanced and would, in our opinion, be wholly inconsistent with NGG's obligation to set cost reflective tariffs. It is our understanding that the issues raised by WWU in support of its modification are mechanical, relating to the DN price control arrangements. Given the DN's agreed to the price control settlements coupled with the fact that the impact is primarily one on cash-flow we do not believe that this is a suitable justification to delay any changes to NTS charges which ultimately lead to them being more cost reflective.