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	
Representative:	Andrew Mackintosh
Organisation:	Calon Energy (formerly MPF Operations)
Date of Representation:	
Support or oppose implementation?	0517 - Oppose 0517A - Oppose 0517B - Oppose
Alternate preference:	*If either 0517, 0517A or 0517B were to be implemented, which would be your preference?* 0571B
Relevant Objective:	**a)** Negative for all three proposals **aa)** Negative for all three proposals **b)** Negative for all three proposals **c)** Negative for all three proposals **d)** None

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

All three proposals are based on the presumption that the supply merit order constructed for a peak demand day supply merit order correlates with the historical supply merit order experienced on a 'cold day'. The proposals fail to provide any rationale as to why a 'cold day' is a reasonable proxy for a peak day and it is certainly the case that the evidence produced is wholly insufficient to justify such a material impact on prices.

Further, even if it could be proved that there is a linkage between the two measures of demand, the analysis presented is historical and no attempt has been made to

determine whether historical levels of demand, particularly over the limited period examined, and resultant supply merit orders, can be relied upon to forecast future supply patterns. Certainly, National Grid's Future Energy Scenarios maintains the position of storage at the bottom of the supply stack (see Figure 125, FES July 2014).

Finally, consideration must be given to effect of the change on prices. Perhaps most striking is the extreme impacts on prices, particularly exit capacity, which, we would argue highlights the sensitivity of the model to fairly modest changes in supply flows, as set out in Appendix 1 of the draft modification report. Not only do the price effects bring into question the justification for altering the merit order based on the evidence provided in the proposals, but more generally the suitability of the charging regime to a physical network which is fundamentally changing in terms of the location and direction of flows.

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

Calon Energy does not support the implementation of any of the proposals. However, in the event that they are implemented, a lag of at least two years should be applied between decision and implementation.

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

Calon Energy would face material additional capacity costs at the two CCGTs located in Wales. By way of example, Appendix 2 forecasts increases in Exit capacity costs for Baglan Bay of over 4000%

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.*

Modification 517 states that "the merit order will be kept under review to ensure that any changes in supplies on the NTS can be discussed with industry and any potential modifications raised." This statement is highly concerning and should be revisited. In essence, it implies that the merit order is transient and should be revised, we assume, on the same basis applied in the three proposals i.e. a historical snapshot of cold day flows. Nothwithstanding the fact that Calon Energy does not believe that a case has been built to link the two measures of demand (peak and cold day), such an open-ended approach to resetting a single component of the charging methodology engenders an environment of uncertainty and unpredictability. This will inevitably generate greater investment risk and conflict with wider aspirations for a secure electricity market and positive economic growth.

The Modification Report has failed to consider the wider implications not only material one-off changes to charges, but also of the ongoing threat of any future changes.

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

The proposals need to be considered in conjunction with the EU Tariff Code and Ofgem's Gas Transmission Charging Review. There is an expectation that the requirements of the Tariff Code, in combination with the GTCR outputs, will lead to some significant changes to NTS tariffs, both in terms of the underlying methodology and the resultant charging functions. For example, changes to the capacity/commodity split, capacity reserve prices and the classification of interruptible capacity are three areas which are expected to be introduced, albeit at this stage the precise details have yet to be specified. Based on the expectation of these significant changes, due to be implemented in 2017/18, it would be premature to introduce a change to the merit order which will result in huge swings in capacity prices. In order to manage price volatility and predictability, it is in the interests of the GB gas market and its customers to limit the number of price changes and defer any resetting to a single date in the future.

In terms of the wider issues, as outlined in our previous comments, we have grave concerns over the legitimacy and viability of the current charging methodology.

A positive output of the analysis carried out to support the development of the proposals is that the deficiencies of the Transportation Model have been highlighted. The hyper-sensitivity of prices to changes in the underlying flow assumptions indicates that the Transportation Model and the associated charging methodology is not fit for purpose and needs to be reviewed in conjunction with the upcoming changes required under the EU Tariff Code and Ofgem's GTCR. It is worth noting that in NGG's response to the Ofgem GTCR Potential Impact Assessment consultation[1], it stated in Annex 2 that "*we would therefore welcome the opportunity to discuss reviewing aspects of NTS Exit charging at the same time or on a similar timescale to GTCR. This would, if delivered as part of a single step change in the capacity charging methodology coinciding with the EU Tariff code, reduce the complexity associated with multiple separate changes and implementation programmes*" Given this statement, it would appear that NGG agrees with our recommendation of a review of the charging arrangements, albeit specifically in relation to NTS Exit Capacity charges, and its raising of modification 0517 seems to be at odds with this position.

As a major investor in the UK energy market, having recently acquired three CCGT's, Calon Energy is deeply concerned over the lack of stability in gas transmission costs. Changes, such as those proposed in Mod 0517 have serious repercussions on the gas generation market at a time when there are well publicised concerns over security of supply coupled with a desire to maintain the impetus to decarbonise the energy market. Predictability and stability in transmission costs are essential components which underpin investor confidence. For this reason Calon Energy must reiterate its objection to these modifications and requests that a full and proper review of the defunct transmission charging methodology is carried out with some urgency.

[1] NGG response to Ofgem GTCR Impact assessement, 27 March 2015