



Mr. Julian Majdanski
Joint Office of Gas Transporters
Ground Floor Red
51 Homer Road
Solihull
West Midlands
B91 3QJ
enquiries@gasgovernance.com

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Dear Julian,

Re: Modification Proposals 0116/0116A/0116B/0116C: “Reform of the NTS Offtake Arrangements”

The Association of Electricity Producers welcomes the opportunity to comment on these modification proposals. The Association and its Members have been actively involved in discussions concerning reform to the NTS offtake arrangements for a number of years. Depending on which, if any, of these proposals is accepted then there may be significant impacts on the operation of CCGTs and the efficient interaction of the gas and electricity markets. The Association considers the raising of the four alternatives, three of which by parties with significant interests in NTS connected gas-fired generation, demonstrates a lack of consensus in the industry over the need for these changes and concerns over the potential impact intended or otherwise that the implementation of National Grid’s original varied proposal 116V may have.

The Association of Electricity Producers (AEP) is the UK trade association representing electricity generators. It has some 90 members ranging from small firms to large, well-known PLCs. Between them they represent at least 90 per cent of the transmission connected generating capacity and they embrace nearly every generating technology used in the UK. Many member companies have interests in the production and development of renewable energy where the government has set ambitious targets for development over the next decades.

The Association supports the implementation of Modification Proposal 0116A

The Association does not support the other alternatives.

Amongst these proposals, we would rank our support for them in the following order: (least worst first). 116A, 116CV, 116BV, 116DV, 116V

Our comments are as follows:

The Association notes that these current reforms arise from the DN sales process and the consequent desire to commercialise the NTS / DN interface and to treat all offtakes in the same manner as a means of ensuring non-discrimination by NG NTS in the products and services it provides to NTS connectees. However reforms to the NTS exit capacity arrangements had been considered prior to this but had failed to find a way forward.

The Association does not accept that NG must treat all offtakes in the same manner for it to demonstrate that it is not discriminating between different types of connectee. This has not been an issue in the past and going forward could be monitored using information which NG should publish in order to comply with the EU Gas Regulation on access to transmission networks. It will also be the case that treating all offtakes in the same manner will fail to recognise the very real differences between the offtakes in terms of whether they are a commercial or regulated entity and the complexity of operation at multi-shipper offtakes. We note that EON UK has sought a legal view from counsel and we consider that this underlines the view that the offtakes are not all materially comparable and therefore that it may be discriminatory not to reflect these differences in the contractual arrangements. We therefore offer full support for the EON UK alternative proposal 116A.

However we would expect that if any of 116V, 116BV, 116CV or 116DV are implemented which are all based on treating offtakes in the same manner, particularly with respect to flat capacity, that the principle must be applied in a consistent manner across other aspects of the regime that apply at the NTS offtake. Charging is a current example where inconsistent approaches between offtake points are being considered. In such a scenario NG could be accused of discriminating between offtake types and Ofgem if it were to approve such changes to inconsistent regulatory practice.

Our ranking of 116CV, 116BV, 116DV, 116V arises from our concerns over the introduction of a flexibility product, particularly when NG has stated that it would not anticipate investing specifically to provide flex capacity as it does not believe it would be efficient to do so. Historically flexibility utilisation has been well below the proposed baseline level of 22mcm. So in reality we would not expect to see any operating difficulties such as flexibility constraints unless behaviours change significantly or if NG is unable to make available baseline flexibility. We consider the latter of these to be unlikely given that NG as a risk adverse transporter will have set this level conservatively. With respect to the former it is more difficult to predict the future but it is not inevitable that flexibility utilisation in aggregate across the network will increase to levels that routinely exceed the baseline levels. It could therefore be argued that introducing a flexibility product of this type is a disproportionate reaction to a potential problem that might never occur. Indeed the only aspect of flexibility that needs to be addressed is to ensure sufficient is available to DNs to demonstrate compliance with its safety case in meeting 1 in 20 demand and the current arrangements provide for that. It is also understood that peak flex does not coincide with peak demand so DN requirements may not be very large. Given that the majority of the implementation and ongoing costs of this type of reform are expected to arise from the flexibility aspects of the proposals whilst any potential benefits seem to be related to flat capacity we consider that the Centrica proposal 116CV would have merits over and above 116BV, 116DV and 116V. This would provide participants with more information concerning flexibility utilisation and a greater understanding and engagement in discussions if it became

apparent that actual flexibility utilisation was changing in a manner that could lead to operational issues in the future.

If it were decided that a flexibility product should be introduced with effect from 2007 then we would favour 116BV over 116DV and 116V since we have serious concerns as to the impact mod 116V may have on the electricity balancing mechanism. Whilst we recognise that the introduction of electronic OPN submission and the use of OPNs for applications for short term flexibility will go some way to minimise the operational changes required to manage any flexibility product. There are a number of issues of concern these are:

- The tolerance level - in mod 116 this is set at 1.5%, whereas 116BV and 116DV suggest 3%. The latter is more consistent with current operational practice, NExA tolerance levels and would avoid having to resubmit OPNs for very small offtake changes.
- The interaction with the electricity Balancing Mechanism (BM) and the release of short term flexibility. Balancing mechanism bids and offers are generally accepted with very short lead-times, of the order of a few minutes. Hence for CCGTs the revised OPNs that accompany these gas offtake changes will be submitted with very short lead-times. These OPNs may indicate an application for short term flexibility or may notify that less flexibility is to be used. Modification 116V contemplates that all applications for short term flexibility will be assessed and accepted or otherwise on the next hour bar. We acknowledge that this is supposed to address any concerns over discrimination but this delay may inhibit the efficient interaction of the gas and electricity markets. Whilst it may not be practical to accept or reject OPNs in real-time or by return, the time delay introduced by not considering and accepting or rejecting OPNs as they are received creates unreasonable risks for CCGTs and may increase the cost of CCGTs providing flexibility to the electricity market to cover the risk of incurring overrun charges. This delay could also lead to additional stresses on the gas system that may otherwise have been avoided. These could arise if within the time leading up to the next hour bar a number of OPNs associated with BM offer acceptance are submitted, whereas if the first of these had been rejected more quickly BM offers may have been withdrawn avoiding further stresses on the gas system. Clearly my assumption is that a CCGT will comply with the BM offer acceptance but in reality the relative costs arising from the two markets will be considered.
- Overruns – the concerns raised above are alleviated to some extent by the part of 116BV that proposes flexibility overrun charges should only apply when there is a physical constraint on the system and a flexibility constraint day has been declared. This would lessen the impact of assessments of short term flexibility applications being made on the next hour bar. I would also provide for a more dynamic and efficient interaction between the gas and electricity markets.
- Intertrips and forced outages – these are relatively infrequent and unpredictable events but can result in a significant increase in flexibility utilisation as typically offtake would drop to zero. However it is not necessarily the case that a trip would result in increased linepack depletion at 2200. This is because of the time lag involved in renominating gas supplies following a trip, renominations may not occur immediately until the likely duration of the outage is known and then there will be a lag before any change in physical gas supplies takes effect. It therefore follows that for any trip occurring before 2200 the impact on linepack depletion would be

significantly less than if such a profile had been planned and gas supply nominations adjusted accordingly in advance. For any trip occurring just before or anytime after 2200 there will be no impact on linepack depletion at 2200 although flexibility utilisation will have increased markedly. For these reasons it would not seem reasonable to penalise affected parties through them potentially incurring overrun charges. Alternative 116BV addresses this issue.

Extent to which implementation of the proposed modification would better facilitate the relevant objectives

Gas Transporter Licence Standard Special Condition A11.1

- (a) *the efficient and economic operation of the pipe-line system to which this licence relates;* NG considers that this proposal, by allowing users to register their NTS exit requirements beyond September 2010 would enable it to undertake better informed investment decisions. Since 116V, 116BV, 116CV and 116 VD are essentially the same in this regard they must further this relevant objective to the same extent.

Since existing capacity holders will have prevailing rights established at the initialisation of the arrangements if 116V, 116BV, 116CV or 116VD are implemented this principle only applies to incremental capacity. Under the transition arrangements a mechanism exists where incremental capacity requirements may be signalled and secured by entering into an Advance Reservation of Capacity Agreement. Such agreements are bilaterally negotiated, and therefore allow for some flexibility in terms of quantity and delivery date, whereas the proposals detailed in mod 116V seem to limit such flexibility for shipper and DN users, given the July application window and October start date for incremental capacity. Alternatives 116BV and 116CV propose that at new exit points capacity reservations should be able to be made outside of the July application window and for start dates other than October for both UNC parties and non-UNC parties in order to afford this flexibility to all parties in a non-discriminatory manner and to provide information to NG earlier than would otherwise be the case to support efficient decision making concerning investment that may otherwise be less optimal if this information had been withheld until the next July application window. Therefore 116BV and CV further this objective to a greater extent than 116V.

We note that NG in its variation to 116V suggest that a further modification it may raise may partially address this issue, but absent this proposal it is not considered relevant in terms of these modification proposals.

Mod116A allows for the continuation of the existing arrangements which allow for flexibility over start dates to be negotiated and for renegotiation if project timescales change. It may also be the case that if 116V were implemented that some of the close co-operation that currently takes place between developers and NG concerning timetables may be diluted as NG may have to build to an agreed delivery date even if the CCGT project is delayed. Indeed it may also be the case that this new commercial regime incentivises NG to do that as it does not reflect the physical reality of major engineering projects.

The provision of additional information concerning the amount of flexibility used, a feature of mod 116BV and CV, will promote more efficient system operation as users learn to predict when constraints may occur and to manage their usage and flexibility procurement. Similarly the targeting of any net costs arising from flexibility constraints within an area (as in mod 116BV) will encourage more self correcting behaviour which could be more efficient than recovering costs from all capacity holders, a feature of mod 116V.

We also consider that it would be more efficient to adjust holdings of daily flexibility consistent with the prevailing IOPN. Mod 116BV provides for both the upward and downward adjustment, whereas 116V only allows for an upward adjustment. This feature is important as it will prevent hoarding of flexibility as may occur under mod 116V where there is no downwards adjustment. Adjustments in both directions are more likely to be consistent with efficient system operation as it will be possible to reallocate flexibility and in the limit avoid calling a flexibility constraint day which otherwise could arise if daily flexibility was not reduced in accordance with prevailing IOPNs as NG would not know if previously secured flexibility would be utilised or not.

- (b) *so far as is consistent with sub-paragraph (a), the coordinated, efficient and economical operation of (i) the combined pipe-line system, and/ or (ii) the pipe-line system of one or more other relevant gas transporters;*

We consider that mod 116 and all its variants further this objective to a similar extent in that all provide for information concerning incremental investments.

- (c) *so far as is consistent with sub-paragraphs (a) and (b), the efficient discharge of the licensee's obligations under this licence;*

The most relevant licensee's obligations would seem to be those relating to discrimination and whether it is necessary to treat all offtakes in the same manner in order to avoid discrimination. We consider that whilst this might appear to be neat solution from a purely theoretical viewpoint that the practical implications need to be considered. To suggest that absent reform NG NTS may discriminate would seem to imply that NG does not take its licence obligations seriously. This is not our view nor are we aware of any complaints alleging that NG NTS has behaved in a discriminatory manner. This would suggest that licence conditions are sufficient to ensure discrimination does not occur.

This relevant objective also challenges whether the proposals under consideration are consistent with the efficient discharge of the licensee's obligations. As we consider that licence conditions themselves should be sufficient it is by no means clear that additional measures are required to ensure this. Hence those additional measures, absent other benefits, would not be efficient.

Furthermore treating all offtakes in the same way when they are not ‘materially comparable’ may in itself give rise to discrimination, as the one size fits all approach would fail to take account of the real differences between different types of connection to the NTS. Some connections are themselves subject to regulation, some serve other jurisdictions, and others have purely commercial drivers. It is therefore not self evident that the most appropriate outcome to avoid undue discrimination is to treat all offtakes in the same manner.

However if it is deemed appropriate to treat offtakes in the same manner then this principles must be applied consistently both now and in the future across a wide number of issues affecting offtake.

In this context 116BV and CV provide for the same treatment of parties at offtake by allowing Users and non-UNC parties (developers) to signal their requirements for incremental capacity in the same manner and affording them the same flexibility regarding when commitments are made and start dates. Mod 116 appear to restrict UNC parties to July applications and start dates from October, whereas non-UNC parties may agree bilateral terms in an ARCA.

(d) *so far as is consistent with sub-paragraphs (a) to (c) the securing of effective competition:*

(i)&(ii) between relevant shippers and suppliers;

The proposer considers that 116V facilitates achievement of this objective by offering NTS exit capacity on a non-discriminatory basis and by better reflecting the value placed on capacity via the costs of constraint management.

However it is not clear how this facilitates this objective as it is expected that most flat capacity will be allocated as prevailing rights. The allocation of prevailing rights itself may harm competition at multiple shipper offtakes as those that have rights today may not be the same parties that need rights in three years time. Competition for flat capacity will only occur at multiple shipper offtakes such as storage and interconnectors in the shorter term, but only then for capacity above the prevailing rights level and upto baseline. At these offtakes it is not entirely clear that competition is desirable as it could have unintended consequences that are not consistent with normal commercial operation, that could undermine commercial flows to storage facilities, Europe or Ireland. We expect such offtakes will need to take steps to ensure these undesirable consequences are avoided; therefore the proposal cannot be justified on this basis.

There will be some competition in offering flat capacity back to NG NTS where it is required but this is expected to be infrequent and therefore not really significant.

With regard to flexibility capacity shippers will compete with each other and DNs within zones and areas but as explained below it is not obvious that this will be fair competition. It is also not obvious that at the customer level the best outcome will be achieved as a site

with more than one shipper could have both shippers competing for capacity in that zone and hence paying a higher price than if the flexibility was specific to an offtake point. Again such offtakes may appoint an overrun user to work around the problems arising from this proposal.

Another significant concern is that the complexity, cost and risk of the arrangements may create a barrier to participation in the market for supply to NTS connected loads.

To some extent 116BV and to a greater extent 116CV offset these concerns by providing some protection from flexibility overrun charges and not imposing SO flexibility commodity charges and by taking an incremental approach to reform which would seem to be a more proportionate response to the identified issues.

(iii) between DN operators (who have entered into transportation arrangements with other relevant gas transporters) and relevant shippers;

Competition between DNs and shippers in respect of flat capacity will largely be limited to offering constraint management products, as this is expected to be infrequent it would appear to be conceptual rather than actual.

With respect to flexibility there will be limited competition between DNs as there is little overlap between the DN areas. DNs will compete with direct connects for flexibility within zones and areas. However it is not clear whether this will be fair competition, as DNs have alternative means of providing flexibility in their networks whilst the vast majority of direct connects do not. This will also depend on the extent to which DN flexibility costs can be passed through, this is not known yet.

(e) so far as is consistent with sub-paragraphs (a) to (d), the provision of reasonable economic incentives for relevant suppliers to secure that the domestic customer supply security standards (within the meaning of paragraph 4 of standard condition 32A (Security of Supply – Domestic Customers) of the standard conditions of Gas Suppliers' licences) are satisfied as respects the availability of gas to their domestic customers; and

We do not consider that this objective is impacted by any of the proposals

(f) so far as is consistent with sub-paragraphs (a) to (e), the promotion of efficiency in the implementation and administration of the network code and/or the uniform network code.

We do not consider that this objective is impacted by any of the proposals

The implications of implementing the Modification Proposal on security of supply, operation of the Total System and industry fragmentation

The Association believes that implementation of any variants of mod 116 apart from 116A will lead to a reduction in the supply security. This is because the concept of long-term interruptible NTS sites will no longer exist. It is anticipated that many currently interruptible sites will secure

firm prevailing capacity rights with the remainder possibly seeking to secure interruptible capacity on a daily basis. However as NG is required to offer baseline capacity upto and including on the day these sites may choose to secure firm daily capacity at peak times. It then follows that there would be less interruptible capacity available to call at stage 1 of a network gas supply emergency than is currently the case. This would lead to a more rapid progression and escalation of the emergency to stage 2 & 3 and potentially to stage 4 aswell. We therefore consider that implementation of any variant other than 116A could have the unintended consequence of leading to a reduced level of supply security. In addition, if an interruptible site goes firm, it may permanently decommission its backup fuel system, such that its interruptible capability would not be available to the NTS in the future should the requirement for interruptible capacity increase, thus further decreasing the level of supply security.

Security of supply in the electricity market may also be affected if developers are unable to commit to incremental capacity in timescales consistent with project timescales rather than only in the July applications window which is a feature of Mod 116V and 116VD. The flexibility afforded by Mod 116A, 116BV and 116CV will ensure that commitments for incremental capacity requests can be made once the project has approval, rather than having to wait until the next applications window. This delay could lead to incremental capacity being delivered later than required.

The implications for Transporters and each Transporter of implementing the Modification Proposal, including

a) implications for operation of the System:

The proposals apart from 116A provide a wider range of system management tools for NG to manage system constraints (subject to user participation), but do remove the option of long-term interruption contracts where system capability exists.

The enhanced information provision in relation to flexibility utilisation as part of 116BV and CV will enable participants to respond to anticipated constraints, potentially leading to less intervention by NG. The targeting of neutrality costs, a feature of 116BV should also encourage self correcting responses.

b) development and capital cost and operating cost implications:

We expect these issues to be more fully explored in the updated Ofgem impact assessment and NERA report for the Gas Forum. However we would anticipate that the flexibility elements will entail the largest proportion of costs.

c) extent to which it is appropriate to recover the costs, and proposal for the most appropriate way to recover the costs:

We understand that the cost of implementing these proposals that are deemed to arise from DN sales and are not intended to be recovered from Users. Although it is not clear whether the ongoing operational costs are also considered in this way.

d) analysis of the consequences (if any) this proposal would have on price regulation:

Revised transmission and distribution charging methodologies will need to be progressed,

The consequence of implementing the Modification Proposal on the level of contractual risk of each Transporter under the Code as modified by the Modification Proposal

The level of risk faced by a transporter will be addressed by the appropriate price control and associated incentives.

The high level indication of the areas of the UK Link System likely to be affected, together with the development implications and other implications for the UK Link Systems and related computer systems of each Transporter and Users

Modification 116A would require little, if any, change to existing systems. 116CV would require less change than other variants as the billing aspects of flexibility would be avoided. 116BV would require less change than 116 or 116DV as some of the billing elements are avoided.

The implications of implementing the Modification Proposal for Users, including administrative and operational costs and level of contractual risk

The administrative and operational costs for Users and the level of contractual risk will increase for all options apart from 116A. With regard to the other variants the extent to which these costs and risks will increase will vary being the lowest for 116CV rising for 116BV, 116DV and 116.

Users would need to renegotiate downstream or supply contracts for direct connects.

At multi-user sites new allocation arrangements will need to be put into place otherwise users may face overrun charges as a result of the actions of other which are beyond their control. This is particularly acute at interconnectors and storage offtakes.

The implications of implementing the Modification Proposal for Terminal Operators, Consumers, Connected System Operators, Suppliers, producers and, any Non Code Party

Consumers will see no change if 116A is implemented and minimal change if 116CV is implemented.

If other variants are implemented contractual changes may be required to reflect new cost elements, longer commitment periods and processes for changing capacity levels. Individual consumers directly connected to the NTS will be uncertain as to whether their shipper holds sufficient flexibility to meet their offtake requirements and the extent to which any holdings are shared between other offtakes.

Consumers may face additional charges if flexibility commodity charges and overruns are passed through.

Consequences on the legislative and regulatory obligations and contractual relationships of each Transporter and each User and Non Code Party of implementing the Modification Proposal

The complexity and cost of the proposals may hamper trade with other Members States, and is not consistent with harmonisation principles.

Analysis of any advantages or disadvantages of implementation of the Modification Proposal

We have identified the following advantages:

116A

- Provides a least cost, proportionate solution
- Avoids treating materially different types of users in the same manner
- Avoids unnecessary cost and complexity

116CV

- through the publication of additional information concerning the utilisation of flexibility provides a means to assess whether further changes are required in the future

116BV advantage over 116V and 116VD

- reduces the impact on the electricity market balancing mechanism by removing Flexibility commodity charges and applying overruns only when there is a physical constraint.

We have identified the following disadvantages:

All proposals apart from 116A, with 116C to a lesser extent than other variants

- introduce additional cost and complexity to the management of NTS exit capacity
- require extensive changes to transporter and shipper systems
- will have an impact on the role of CCGTs in the electricity balancing mechanism
- will have a disproportionate impact on multi-shipper offtakes
- potentially damages security of supply
- potentially conflicts with EU Regulations

The extent to which the implementation is required to enable each Transporter to facilitate compliance with safety or other legislation

We expect that NG NTS will have to seek a change to its safety case rather than this arising from a change in safety legislation.

The extent to which the implementation is required having regard to any proposed change in the methodology established under paragraph 5 of Condition A4 or the statement furnished by each Transporter under paragraph 1 of Condition 4 of the Transporter's Licence

Programme for works required as a consequence of implementing the Modification Proposal

Proposed implementation timetable (including timetable for any necessary information systems changes)

Implications of implementing this Modification Proposal upon existing Code Standards of Service

Further Comments

Yours sincerely

Julie Cox
Association of Electricity Producers