

The logo for Viridian, featuring the word "VIRIDIAN" in a white, serif font on a dark green rectangular background.

## Viridian Power & Energy Ltd

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### **Re: Modification Proposals 0116V/0116VD/0116A/0116BV/0116CV: “Reform of the NTS Offtake Arrangements”**

Dear Julian,

As a major gas Shipper and gas Supplier in Northern and Southern Ireland, and as a potential UK NTS gas Shipper, Viridian Power & Energy Limited (VP&E) will be significantly affected by any change to the exit point arrangements in the NTS, and hence was actively involved in attending the Enduring Offtake Working Group meetings tasked with discussing the issues pertaining to the UK Exit Reform. VP&E welcome this opportunity to comment on the proposals and ask that this submission is given the same consideration as any other submission in relation to these Modification Proposals.

- Viridian Power & Energy Limited does not support the implementation of this Modification Proposal 0116V and wish to comment as to why.
- Viridian Power & Energy Limited does not support the implementation of this Modification Proposal 0116VD
- **Viridian Power & Energy Limited supports the implementation of this Modification Proposal 0116A**
- Viridian Power & Energy Limited does not support the implementation of this Modification Proposal 0116BV

- Viridian Power & Energy Limited does not support the implementation of this Modification Proposal 0116CV

Amongst these proposals, we would rank our support for them in the following order: (most supported first). 0116A, 0116CV. (**Note:** VP&E does not and could not support either modification proposal 0116V, 0116VD or 0116BV, the former being by far the worst proposal being discussed).

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VP&E's comments are as follows:

VP&E supports Modification Proposal 0116A and agree with the vast majority of the comments raised by the Proposer of Modification Proposal 0116A, both in its Modification Proposal dated 12<sup>th</sup> Oct 2006 and its Representation dated 5<sup>th</sup> Dec 2006 (many of which are echoed by SSE, International Power, the Chemical Industry Association and SBGI Gas Storage Operators Group in their Representations). Like Eon, VP&E does not believe Modification Proposal 0116V will better achieve the Relevant Objectives and indeed strongly believe it will adversely affect the achievement of the Relevant Objective, and further believe it will drive users away from gas to alternative fuels which are “less complex” to procure, price and use. VP&E believes that Modification Proposal 0116A will both better achieve the Relevant Objectives and do so economically, with the least amount of “pain” for gas Shippers, Suppliers, and users, and will better facilitate the continued growth of the gas industry in general by continuing to incentivise users to switch to gas.

VP&E, like many users of the NTS, believe the existing arrangements work, and work very well. While some may view them as treating different types of users differently, this is only because different users are different, and their drivers are different. The claim that the existing proposals may lead to undue discrimination is unfounded as it is commonly understood that no party has ever claimed undue discrimination. To quote the wise old saying “if its not broke don't fix it” is very appropriate to this exit reform process. For some reason it appears someone is trying to find a problem in order to justify creating a new solution, when in fact there is no problem, at least no genuine problem. The lack of a problem explains why it has proved impossible for parties, through the Enduring Offtake Working Group meetings, to agree anything, or reach any form of consensus, in relation to a “new solution” – most parties simply could not, and can not, understand the problem the Exit Reform is trying to address, and as such simply could not contemplate a “solution”.

### **Flat Capacity:**

In relation to the Flat Capacity product most people understand Ofgem and NGGs desire to have investment signals. Indeed most parties believed the current arrangements are working but openly committed to Ofgem and NGG that they would be willing to work with them more proactively if necessarily in order to give NGG (and Ofgem) comfort in this regard. There are several issues that should be considered here;

- (i) if NGG over-invest Ofgem and other parties are likely complain that money has been potentially wasted and the transportation costs are too high
- (ii) if NGG under-invest Ofgem and other parties are likely to complain there is insufficient capacity available for users to meet their requirements so the system is not being used to its optimum
- (iii) NGG has consistently stated it will not invest purely to provide flexibility and yet extra flexibility in many cases may in fact resolve the issue in question. NGG state they will only invest when flat capacity is needed – but when new pipes go into the ground extra flexibility is inherently released.
- (iv) It is unreasonable and indeed inappropriate to expect retail gas suppliers to commit to 4 years worth of capacity costs 3 years in the future. With the best will in the world retail gas suppliers simply do not know what their customer base will look like in even a few month time never mind 7 years in the future due to the ability of customers to change supplier.

Considering the above it is reasonable to argue that the gas system investment process should be driven from two sides – one being the longer term commitment given by parties who are comfortable to commit longer term (possibly through an ARCA type arrangement) e.g. DNOs, power stations, etc – and one being the long term “plan” looking at the “bigger picture” which only NGG can perform properly. There does not appear to be a better solution than using NGG to perform this role given its experience and knowledge of the NTS. Longer term “planning” must continue to be performed by NGG to ensure the best most economical solution to gas requirements otherwise there is a real and genuine risk that users who wish to use the system will not be able to do so as there will be insufficient capacity. This will occur due to the following;

- i. It is very likely that many users will not be willing to commit to the financial commitment proposed in the NGG proposals.
- ii. DNOs will have to assess Domestic users gas usage growth. Given the financial implications of the NGG proposals DNOs are likely to be cautious in this and thereby likely to underestimate.

NGG should be allowed to “plan” to take account of the “big picture” which will hopefully address (i) and (ii) above and the various other scenarios that could lead to inaccurate forecast information, and they should be recompensed for the decisions they take in relation to this (once the decision has firm justification with written back-up report detailing the “reasons why”). This planning activity should be allowed to extend to influencing the size of pipe put in the ground. When a pipe is being put in the ground, its size should be carefully considered by NGG in order to ensure the optimum economical solution in the long term. For instance if by virtue of some long term commitments, NGG need to build a new pipe line which is sized to meet the committed to financial impact at 12 inch diameter. However gas demand in the area has been growing steadily and it is likely that in a short period of time another new pipe will be needed. If this forward growth is taken into account the cost of putting in a larger pipe initially will be dramatically less than putting in two 12 inch pipes. Strict interpretation on the rules appear to preclude NGG for taking this least cost approach. This needs to change even if each instance of this has to be approved by Ofgem in advance.

The details above outline some of the reasons why the Flat Capacity product as outlined in Proposal 0116V will not bring about the best solution. It will be onerous on Shippers and Suppliers, and is unlikely to achieve the optimum use of the NTS system, thereby increasing unit costs for all end users. For these reasons VP&E does not support the proposed mechanism of dealing with Flat Capacity as outlined in Proposal 0116V, and thus support Proposal 0116A.

### **Flexibility Product:**

In relation to the Flexibility Product VP&E would like to point out its agreement with, and support of, many of the arguments made against the introduction of the Flexibility Capacity product by the Proposer of Modification Proposal 0116CV. VP&E agrees with the Proposer of Modification 0116CV that the Flexibility product should be excluded from any Proposal for the following reasons:-

***1. Investment Signals** – The signals for economic and efficient investment is cited as one of the main objectives of National Grid’s proposal. National Grid have clearly stated that there would no investment in the network specifically for Flexibility. (This is also consistent with NGG’s licence obligation to invest for the 1-in-20-peak day.) The Flexibility that exists is a bi-product of the establishment of the size of the Transmission network, which is itself driven by (flat) capacity requirements. It follows logically from this that the removal of the process for sale of a Flexibility product does not detract from any objective of the original Proposal to provide investment signals.*

VP&E would further contend that by taking the stance that no investment will occur for Flexibility the “investment signals” received from the Auction process for Flexibility Product will be completely ignored, thus making the introduction of the product meaningless.

***2. Quantification of the Flexibility Product** – National Grid have demonstrated convincingly that the amount of Flexibility available on any single day is dependent upon a number of unpredictable factors. Therefore it is impossible to forecast, with any level of confidence or reliability, the amount of Flexibility available more than a day or so ahead. This does not support the sale of a Flexibility product to all Users on a long-term basis, which is most unlikely – for a number of reasons – to be an economic and efficient solution.*

Further two facts must be borne in mind;

- (i) NGG have to enter contracts with parties to allow them to buyback flexibility when they need it,
- (ii) in the event of emergencies NGG will be able to use the flexibility of the system as they so wish to deal with network problems.

These facts combine to defeat the purpose of taking the flexibility away from NGG as proposed by Modification 0116V. Optimum use of the NTS can only be achieved if system flexibility is left in the control of NGG allowing them to sweat the assets to their maximum potential. Devising a pseudo mechanism where it appears others have control of the flexibility is completely inappropriate, and contrary to what should be in place to ensure system security.

**3. Artificial Scarcity of Flexibility** – Given the unpredictability described in (2) above, the amount of Flexibility which can be offered in the long-term is of necessity limited to the lowest number that can be guaranteed by the Transporter to be available at a date far in to the future. Experience has shown that all Users' and Distribution Networks' use of flexibility is unpredictable and not co-incident. Therefore in order to be certain of acquiring sufficient Flexibility for days of maximum use it is necessary to book Flexibility for all days, perhaps with a seasonal profile. Should all Users and Distribution Networks simultaneously book sufficient Flexibility for their maximum Flow rate variation on all days far into the future, this will inevitably exceed availability and this demand upon the system would never be co-incident.

**4. Sub-Optimal assessment of System Capability** – for the reasons outlined above, the assessment of capacity available in the long term would be conservative and would under-estimate the true potential of the system.

The above will likely lead to sub-optimal use of the system.

VP&E would go further on this point to assert that by taking the “control” of the use of system flexibility away from NGG, it is guaranteed that, depending on who buys the Flexibility Product and where and when they decide to use it, there will be many many occasions when users of the NTS will not be able to get access to the gas required to meet their daily requirements. This will force users to consider other fuels and force them away from using gas. When NGG had full control of the use of system flexibility they could optimise gas flows to ensure gas went to where it was needed. Historically, with NGG in control of the flexibility inherent in the system, it is understood that it was a very rare event indeed (if ever?) that a user did not get the gas it needed on a day. **This is a critical issue which must be considered as part of this proposed reform process.**

**5. Absence of secondary trading or transfer of flexibility** – For those parties able to forecast more reliably their use of Flexibility in advance, mainly DNs, this is likely to be for peak requirements across all days taking account of seasonality. It is likely that this would not be released to other users until there was certainty that it would not be required by the DNs themselves. This would be very close to the gas day, if not within day. This would result in unused Flexibility being unavailable to other Users, i.e. the original Modification would place an artificial Flexibility constraint on the system.

**6. Exposure to flexibility overrun charges as result of other Users' flow profiles** – particularly at locations where there are multiple Users and where there are bidirectional flows, a User may incur a penalty as a result of other Users' flow profiles. The arrangements within the original proposal do not address this problem.

**7. Contrary to EU Regulation 1775/2005** on conditions for access to gas transmission networks. Article 3 requires transmission system operators to actively pursue

*convergence of tariff structures and charging principles and for tariffs not to restrict market liquidity or distort trade across borders of different transmission systems. The Proposer [of Proposal 0116CV] believes the original proposal would hamper liquidity and trade across the IUK and Moffat interconnectors. It is also contrary to convergence with the regimes in neighbouring Member States and therefore working against the ambitions for a liberalised European market. The Proposer also believes that the original Modification Proposal may prevent the unencumbered release of the full capacity potential of the network (Article 5)*

In the EU context Ofgem and the UK are arguing the above point for convergence against other regimes and yet in the context of the UK they appear to take the stance that it can take decisions in isolation without considering this issue and its unwelcome impact on other transmission systems linked to the UK, and other regulatory regimes e.g. Northern Ireland, the Republic of Ireland, Isle of Man. Ofgem are kindly request to reconsider this proposal bearing this in mind and the arguments being made by the UK in the EU arena.

**8. Extreme Complexity** - *All Users and Transporters would be required to establish and maintain sophisticated systems to manage flexibility.*

These systems will be extremely complex and costly. NGG have conceded this in their own submission on the matter.

**9. Exposure to risk** – *the regime proposed in the original version would create high risk for Users unable to acquire flexibility due to the reasons contained in 2 & 3 above.*

**10. High Costs for Users and Consumers** – *The necessity for such systems will generate costs. The acquisition of Flexibility will generate costs. The exposure to overrun charges and SO Commodity (flexibility) charges would also add costs.*

Such additional costs and the risks attached to same will strongly discourage users from either using or switching to using, gas as their preferred fuel. This is certainly not in the interest of anyone in the gas community and is not in the best interest of the planet given the environmental benefits of gas as opposed to competing fossil fuels.

**11. Impact upon other regimes** – *A significant number of NTS connected customers are power stations. The need to book Flexibility for such customers is particularly difficult as the within day profile of gas flows will not be known until very close to the gas day. Should power stations be unable to secure flexibility in the long term, due to uncertainty, and not be able to secure flexibility in the short term, due to the lack of effective Use it or lose it (UIOLI) process (as 5 above), they would be unable to respond to the requirements of the power regime. In that sense, the original Modification would cut across another legitimate regulatory concern, i.e. to facilitate a flexible and economically efficient pattern of power station despatch.”*

VP&E would like to make a few additional points in relation to the Flexibility Product;

**12: Inappropriate allocation of funds:**

As pointed out above, with the uncertainty surrounding the availability of Flexibility at future moments of time, sufficient Flexibility will not be released by NGG to meet all users maximum demands. The figures in relation to national, area and zonal caps provide further evidence of this. Hence it appears most probable that there will be an over-subscription in the Auctions for Flexibility, and that because of this the price paid by the parties who succeed in winning some Flexibility Capacity in the auctions will be higher than the reserve price. This will bring about a situation whereby NGG will almost certainly materially over-recover on their Flexibility Capacity costs. NGG have stated that any over-recovery will be used to reduce the Flat Capacity costs. VP&E understands why NGG are proposing this method of apportionment in that it would be unworkable to allocate the over-recovered funds to a product which is sold in a “pay-as-bid” auction process (another reason not to have the Flexibility Product at all). However VP&E still strongly believes this is a highly inappropriate mechanism of dealing with this. If such a product were ever to come into effect then the best, most logical approach would be to find a solution which allows any over-recovery of funds to reduce the costs of the specific product which has brought about the over-recovery. If the nature of the product prevents this occurring then either the nature of the product should be changed, and if this is not possible, the product should be scrapped and either revert to the old way of dealing with flexibility by leaving it in the control of the Transporter, or an alternative, more appropriate mechanism of dealing with flexibility should be created. VP&E are of the firm view that leaving flexibility in the hands of the Transporter (as it is today) is by far the most appropriate solution as it will maximise system utilisation to the benefit of all gas system users, and benefit all from an environmental point of view.

For all of the above reasons the Flexibility Capacity product as outlined in Proposal 0116V is costly and onerous on Shippers and Suppliers, and is likely not to achieve the optimum use of the gas system, thereby increasing unit costs. For these reasons VP&E does not support the introduction of the Flexibility Capacity product as outlined in Proposal 0116V, and hence support Proposal 0116A.

**Summary:**

VP&E strongly believes that the existing arrangements work, achieve the necessary requirements, and do not unduly discriminate between system users. If Ofgem or NGG still have some doubt in this regard then they should advise other parties exactly what concerns are. VP&E are in no doubt that any concerns could be simply addressed through some small modifications to such issues as the ARCA arrangements and or the flow restriction orders and within day auctions processes. The gas industry does not need to cost or the complexity of the proposals outlined in Proposal 0116V – it will undoubtedly damage the industry and this is not desirable. It is requested that very careful consideration is given to the complexity and the costs. The costs to be considered include both the initial costs for systems, and the on-going costs in relation to the complexity of the operations to cope with the processes outlined in the Proposal 0116V. Regardless of the fact that most NTS players do not believe there is a problem to be fixed, whatever “benefits” one could possibly perceive from the Proposal 0116V will undoubtedly be vastly outweighed by the complexity, and the initial and on-going costs, introduced.

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I wish to thank you for this opportunity to respond to this consultation process. I would kindly ask that our submission be given careful consideration.

Yours faithfully

**Name:** Derek Russell

**Organisation:** Viridian Power & Energy Limited