



## **National Grid Gas – Offtake Arrangements Final Impact Assessment Comments by Association of Electricity Producers**

06 March 2007

The Association welcomes the opportunity to comment on Ofgem's final impact assessment prior to the Authority decision on modification 116 and its variants. We consider this is an important additional process step when initial impact assessments have been undertaken some time ago and detail and understanding of the proposals has developed during that time. We hope this will be repeated for other proposals involving significant change

Our comments are essentially similar to those made in our response to the June TPCR consultation (an extract of which is attached as appendix 1) and we note very little change in Ofgem's views since the initial impact assessment. However one new point we would like to raise is that Ofgem has failed to consider the likelihood of the scenarios which would secure a realistic benefits case. This was a recommendation in the recent House of Commons Committee of Public Accounts report HC110 on the Gas distribution networks sale. In this case it would seem reasonable to consider the likelihood of National Grid gas discriminating between networks and /or offtakes in the allocation of capacity and flexibility and to apply this probability to the identified benefits. Similarly a probability could be assigned to the likelihood of less capacity being delivered as a result of the introduction of a user commitment model. We consider this to be separate from NG delivering the same capacity at lower cost as this is not a direct consequence of this proposal and should not be considered as a benefit of these reforms.

### Efficient NTS investment signals

Ofgem maintains its view that a firm user commitment model will lead to more efficient NTS investment and reduce the risk of stranded assets, yet it is still unable to identify when stranded assets have been created in the past due to the absence of such a model.

Paragraph 3.19 appears to identify stranded assets, not as assets that have been put in place and not used as suggested in paragraph 3.14, but as assets that have been used and have stopped being used. Using this definition there must be significant quantities of stranded assets around the network but it is not clear that these place an unreasonable cost burden on the generality of customers nor that initially connectees were unwilling to make an appropriate commitment to ensure the capacity was provided. It is not clear that these proposals will do anything to address stranded assets as defined in paragraph 3.19.

For large one off investments ARCAs have been necessary for many years which already require a user commitment to be made so it could be argued that any benefits arising from these proposals should only apply to investment that did not previously require an ARCA rather than all NTS capex.

The Association notes that the annual capex forecast has increased from £65M p.a. to £77M p.a. between the initial and final impact assessment yet there is little explanation for this. We also have continuing concerns over the use of 6.5% efficiency savings as this seems to confuse delivering the same capacity more cheaply and delivering less capacity on the assumption that shippers and DNs will request less capacity when they have to make a financial commitment for it. The former of these is associated with the definition of baselines and revenue drivers and is not strictly related to the user commitment elements of the modification proposals.

#### Non-discriminatory allocation of capacity products

To include any benefits relating to non-discriminatory allocation of capacity products must assume that NG will discriminate absent reform. As stated above we consider that a probability should be assigned to this as it would constitute a serious licence breach. We do not consider this is very likely to occur.

#### Reduced incidence of ARCAs

The standardisation of ARCA terms may well reduce the incidence of ARCA disputes, but then so does the 'case law' established by each determination. Absent reform we now have two determinations that state that only one year's NTS exit capacity charges is required as an ARCA commitment for CCGT connections so going forward it would be very difficult for NGG to require any greater commitment unless it could demonstrate that a particular CCGT was more risky than those that had preceded it. In any scenario NGG would face challenge over its ability to assess risk and so would be unlikely to do this. Hence absent reform we consider further determinations for CCGT connections to be unlikely.

#### Sensitivity of the benefits analysis

We consider this to be very weak and would expect it to consider the probability of certain outcomes or to challenge some key assumptions.

Given the uncertainties in these quantified benefits, which are further reinforced in the NERA report, the Association continues to support 116A, with 116CV being the next least worst alternative.

#### Analysis of costs

The Association notes the differences in cost estimates between the NERA report and the Ofgem final IA we consider it would be helpful if these differences could be reconciled.

### Qualitative analysis

We believe that Ofgem's views of the qualitative benefits of the introduction of the flexibility product are one-sided. This is primarily because under the current arrangements CCGTs or other offtakes do not need to reserve flexibility in advance of use. Therefore any reforms including auctions or other processes will not be an improvement on the current arrangements. They will not necessarily allow more efficient CCGT plant to gain access to flexibility in priority to other users. Access to flexibility is essentially unconstrained and we have been advised it is likely to remain so for the foreseeable future. Ofgem also appears to contradict itself in that earlier in the document it argues that it should exclude costs associated with systems for assessing and securing flexibility when constrained and yet here suggests that the proposed flexibility auctions would enhance competition.

We agree that the prevailing rights model and OPN application process for daily flexibility should have reduced shipper costs but that this will already have been incorporated into the shipper costs estimates and so should not be considered as an additional qualitative benefit.

Ofgem also still seems to consider that the reforms will enhance security of supply, as this includes redefining the 1 in 20 obligation and removal of a large tranche of interruptible capacity. It is not immediately obvious to us that this is the case. We still consider that any efficiencies will relate to transportation capacity rather than gas supply with the step change in firm volumes potentially reducing security of supply and increasing the likelihood or progression to stage 3 should a national gas deficit emergency occur. We note that material changes to NEC and transporter safety cases will be required, and hope that the industry will be given the opportunity to comment on this, although we recognise there is no formal requirement for such consultation.

We maintain our view that it is not necessary to treat all offtakes in the same manner to avoid undue discrimination, given the very real differences in the entities involved ranging from CCGTs and industrial sites operating in a commercial environment to regulated networks. We also expect that if Ofgem maintains this principle in a consistent manner that there will be wider unintended consequences in other aspects of the regime such as charging.

### **Appendix 1: Extract from AEP's response to June TPCR consultation**

*A17.1: What are your views on the benefits analysis conducted?*

We think the benefits case is a gross overestimate of the benefits that may arise from the introduction of the enduring arrangements. It seems to imply that the current arrangements will lead to substantial inefficiencies and that NG will discriminate between offtakes in the absence of any reforms when this

would clearly be a breach of its licence condition in a number of areas. Therefore, if NG's behaviour does not change, the main benefit of reform will be improved transparency allowing Ofgem to undertake its market monitoring role more effectively than it current now.

Table 17.3 details forecast incremental NTS exit capacity capex with an anticipation of, on average, a spend of £65M. This references Chapter 11, but this chapter does not consider capex. Chapter 6 discusses capex but there appears to be no consistency with the numbers in table 6.3 nor with those relating to exit capacity investment detailed in the 2005 Ten Year Statement. Further detail of the assumptions supporting this forecast would be appreciated.

We acknowledge that there is likely to be substantial investment in CCGT plant in the coming years to help meet the expected generation gap, however, the Energy Review does not seem to assume that investment will be solely in gas fired plant. We therefore wonder whether assuming £65 M pa. for the next twenty years is appropriate, particularly when other issues such as energy efficiency initiatives and the effects of climate change act to suppress distribution network load growth. Indeed it has already been stated that no exit load related investment is expected in the next price control period except perhaps in the south west quadrant to meet any load growth. It therefore follows that any investment made will be for specific large projects which currently would be covered by an ARCA effectively providing a clear investment signal and financial commitment. Under the enduring arrangements effectively standardised ARCA type terms will be established, so there is little change. Any benefit will only accrue if NG behaves differently and effectively puts less pipe in the ground to deliver the same capacity. Given the fact that pipes are only available in certain size increments this is difficult to envisage. We therefore query the appropriateness of the 6.5% capex saving as this is difficult to appreciate on an individual project basis. Putting the same pipe in the ground more cheaply should be considered separately from these reforms which are clearly aimed at maximising the utilisation of the existing system with benefits accruing from making less investment. Clearly simply using a % saving because it has been used before does not mean this is the correct measure.

It is not clear how the savings arising from the removal of the flow margin are considered in the impact assessment. If this change is accepted then clearly there will be less investment as load growth initially uses this margin before requiring investment. Also it is not obvious why this is linked to these reforms nor if it is actually desirable. Whilst adding a 5% margin onto the 1 in 20 forecast may seem like a 'belt and braces' approach the risks of inadequate capacity far outweigh the costs to customers of investment to provide this safety margin. In terms of security of supply a little overcapacity may not be such a bad thing and may well provide resilience to a wider range of supply / demand scenarios.

We accept that in the absence of change there may well be more ARCAs than there have been in recent years, particularly in connection with new CCGT

investment. We also agree that it is desirable to reduce the number of determinations, given the cost burden this creates on all parties. However it is not obvious that an increased incidence of ARCAs would necessarily lead to more determinations as each determination effectively sets 'case law' for future connections, so long as Ofgem does not keep moving the goalposts. We consider the current case concerning the proposed CCGT at Marchwood has only been referred to Ofgem because Ofgem indicated to NG that the terms of the Langage ARCA were no longer considered appropriate. As Ofgem can therefore influence which determinations occur it does not seem appropriate to consider this as a benefit of reform.

Non-discriminatory allocation of capacity products is another area in which benefits have been quantified; however these are based on the presumption that in the absence of the reforms NG would discriminate between offtakes. As NG would be in serious breach of its licence we would not expect NG to behave in this way given the risks of this being discovered. We accept that the proposals provide for greater transparency of information that would enable any such behaviour to be more easily revealed, however greater transparency under the existing arrangements may similarly achieve such ends.

With respect to benefits that may accrue in the electricity market, we simply do not accept that this will be the case. Whilst the flexibility arrangements are still under development it seems likely that the cost of CCGTs securing flexibility (even if only on constrained days) will be higher than it is now. In addition they may also face overrun charges in certain circumstances; therefore the cost and risk of offering flexibility to the electricity balancing mechanism will at best stay the same or increase.

To summarise, the benefits case seems to be based on the avoidance of certain behaviours by NG that would place it in breach of its licence and it seems highly unlikely that such behaviour would occur. We are therefore extremely sceptical that the quantified benefits will be achieved and will manifest themselves in reduced costs to customers.

*A17.2: What are your views on the cost analysis conducted?*

We find it quite remarkable that Ofgem has eliminated outliers from their analysis given that this is only a draft impact assessment. This is a particular concern given the different levels of understanding of the proposals and engagement of participants in the process. Given the small sample sizes such elimination is unlikely to be statistically defensible.

Clearly the cost estimates will have to be reworked when and if we have greater clarity over the flexibility arrangements. We hope that due consideration will be given to OPN based models in future documents as these provide continuity of existing well established operational procedures.