RWE Supply & Trading

Andy Burgess
Associate Partner
Transmission and Distribution Policy
Office of Gas and Electricity Markets
9 Millbank
London
SW1P 3GE

Name Charles Ruffell
Phone +44 (0)1793 893983
Mobile +44 (0)7989 493580
E-Mail
charles.ruffell@RWE.com

16th September 2013

Dear Andy

Gas Transmission Charging Review – Call for Evidence
June 2013

We welcome the opportunity to respond to the Gas Transmission Charging Review – Call for Evidence. This response is provided on behalf of RWE npower, RWE Generation SE and RWE Supply and Trading GmbH.

The Call for Evidence sets out a broad range of potential issues to be considered in scope of the review. We have provided our detailed responses to the questions raised in Annex 1, below. In summary, our main comments are:

- We believe that the review should be narrow in scope and focus upon understanding the impact of Tariff Framework Guidelines on the GB market and ensuring that our arrangements are compliant. The review will provide an opportunity to review, confirm and, where necessary, refine the provisions of the licence, UNC and charging objectives in this area. A narrow review will avoid creating market uncertainty and potentially leading to an investment hiatus;
- Addressing wider concerns about specific aspects of GB charging arrangements can be taken forward within existing UNC governance arrangements;
- These concerns include the extent to which the Transportation Model remains fit for purpose and exit charge volatility. System users are particularly interested in charging stability and there is merit in considering the balance between potentially fixing gas exit capacity charges and cost reflectivity;
- We recognise that the role of gas going forward is uncertain, largely driven by supply diversity, the need to accommodate changes in supply and demand patterns and flow directions, the impact of renewable electricity on gas generation as well as the on-going requirement for conventional flow profiling for the distribution networks. As a result the gas charging arrangements may need to evolve to be consistent with more variable demand and reducing gas load factors. However, with uncertainty over timescales we see this as being outside the scope of this review;

If you require any additional information or wish to discuss any aspects further, please do not hesitate to contact me.

Yours sincerely

By email so unsigned

Charles Ruffell
RWE Supply & Trading GmbH
Commercial Asset Optimisation UK

ANNEX 1: Response to detailed questions

Question 1: What has given rise to the current balance between charges for access to the transmission network? How might this change in future?

Ofgem has correctly identified in the Call for Evidence that falling capacity bookings and usage has led to a declining trend in revenues collected from the sale of entry capacity. In turn, this under-recovery has resulted in increasing TO entry commodity charges. In the future, we see the potential for a similar increase in the exit TO commodity charge if sales of exit capacity included in the revenue control framework continue to decline.

NGG is increasingly use commodity charges to ensure recovery of revenue allowed under its price control. The new RIIO T1 framework has introduced uncertainty and incentive mechanisms which allows the baseline allowances to flex. There is a linkage between revenue predictability and charging predictability and we are concerned this new framework may exacerbate the volatility and unpredictability of network charges. Arguably, although the charging arrangements are consistent with NGG's revenue control framework they are inconsistent with User requirements.

The role of gas going forward is uncertain. There is potential need for greater network flexibility largely driven by supply diversity (new storage and interconnection projects) the need to accommodate changes in supply and demand patterns and flow directions, the impact of renewable electricity on gas generation as well as the on-going requirement for conventional flow profiling for the distribution networks. As a result the gas charging arrangements may need to evolve to be consistent with more variable demand and reducing gas load factors. However, with uncertainty over timescales we see this as being outside the scope of this review.

Question 2: What issues are there with current charging arrangements? For example:

o Does the charging structure strike the right balance between incentives to use capacity efficiently and investment?

Both entry and exit capacity charges are locational and Users have taken investment decisions in response to signals from the existing charging structure. Given the charging model, these locational signals are cost-reflective and retaining this principle will promote efficient use of transmission network capacity. For instance, we endorse the principle of offering short-term capacity rights at SRMC but accept that over-supply of capacity may dilute incentives to book longer term.

o Is capacity available when needed?

Capacity is generally available when needed. Capacity released over different durations provides Users with flexibility about how they manage their capacity in relation to their changing portfolio requirements.

o Do charging arrangements help NGG to plan network investment?

The requirement to provide a financial user commitment for capacity at specific entry or exit points does help NGG plan network investment, particularly as investment for incremental capacity would need to be underpinned by user commitment. Given the relatively low level of capacity management actions that NGG undertake, it is less clear that the costs of constraints provide a useful signal of where congestion might be relieved by investment.

o How do our current charging arrangements interact with those in neighbouring markets? What is the impact of these interactions?

Where this is interconnection, the charging arrangements will influence how gas flows between Member States. The response to opportunities to arbitrage commodity price differentials will be influenced by

transmission costs to move gas between the interconnected markets and inconsistent arrangements could encourage the export of gas while discouraging imports or vice versa. From analysis presented at the earlier workshop, our view is that the interconnector flows on IUK are highly efficient and reflect the heavy reliance on commodity charges prevalent in GB arrangements, although the position is perhaps less clear for BBL.

We would also highlight an important inconsistency between the entry and exit regimes. At entry, long-term capacity bookings in the QSEC auctions are at a price fixed for the duration of the booking. This provides price certainty which incentivises long-term booking. At exit this is not the case with long-term allocations are at a variable price. Historically this price has been volatile year on year and is sensitive to the assumptions in the Transportation Model. This creates a significant risk and our preference would be to modify the exit arrangements to allow for a fixed exit charge which will tend to back to back with the duration of the project. This approach should be possible given that bookings are underpinned directly by a user commitment.

Question 3: How do current arrangements give rise to these issues?

See previous answers.

Question 4: In the event that there were to be minimal implementation of the Framework Guidelines/network codes as currently drafted, eg no subsequent changes at domestic points, what would be the impact?

We believe that there should be proportionate implementation of the Tariff Framework Guidelines/network codes and the current GB charging arrangements should be largely unchanged except at Interconnection Points. Extending implementation of the Tariff Framework Guidelines/network codes in their entirety to all domestic points has the potential to undermine the GB market and, as currently drafted, the Tariff Framework Guidelines would not solve the concerns set out by Ofgem in its Call for Evidence.. For instance, our understanding is that the current drafting of the Tariff Framework Guidelines proposes an annual floating reference price for setting capacity charges. In our view, if implemented in GB, this would simply replace volatile commodity charges with volatile capacity charges.

Establishing our priorities for the review

Question 5: Are our goals for the review appropriate?

In our view, the goals set out in the Call for Evidence are too broad. Primarily, the review should be about understanding the impact Tariff Framework Guidelines on the GB market and ensuring that our framework is compliant. In particular, if there are different arrangements at IPs and domestic points, these will need to be developed to ensure that they are workable and avoid creating market distortions. Addressing wider concerns about specific aspects of GB charging arrangements can be taken forward within existing UNC governance arrangements.

Question 6: How could charging arrangements better meet the objectives set out in NGG's special standard condition A5 which sets out the objectives for NGG's charging methodology?

We believe that the current charging arrangements meet the objectives of the charging methodology. The methodologies employed by National Grid have been regularly assessed in accordance with the relevant licences and approved by the Authority under the Gas and Electricity Acts.

Question 7: Do the objectives set out in NGG's special standard condition A5 remain fit for purpose? If not, how should they be changed?

The current licence objectives (facilitating competition, cost reflectivity, taking account of developments in the licensees' transmission business, compliance with EU Regulations and non-discrimination) have to date supported developed of the most competitive and liquid gas market in Europe. Given the potential changing role for gas going forwards, there may be merit in considering the relative balance and priority between these objectives, In our view, objective (e) ***compliance with the Regulation and any relevant legally binding decision of the European Commission and/or the Agency for the Co-operation of Energy Regulator***s should be the key focus of this review.

Question 8: What other suggestions do you have for the objectives of our review?

An overarching objective for the review should be to minimise the amount of uncertainty and regulatory risk it creates in the market. Uncertainty about future charging arrangements will adversely impact upon investment decisions.

Question 9: What is your view on the timescale for our review?

It is not immediately clear what the proposed timescale is, particularly as the Tariff Framework Guidelines are still in development. Given our comments at 8 above, the review should be short.

Our options

Question 10: Bearing in mind the issues and objectives you have identified, what options should be explored to address these?

Ofgem should continue to engage in the development of the Tariff Framework Guidelines and subsequent Network Code. This should allow the Charging Review to focus on understanding the requirements for roll-out at IPs and any wider impacts on GB that emerge as the Network Code is finalised.

Question 11: What are the pros and cons of your suggested option?

Arguably the protracted duration and breadth of scope of Project TransmiT considering electricity transmission charges might have contributed to an investment hiatus. A narrowly focused, short-duration review should avoid that in the gas market. Clarity around the regulatory regime will allow the industry to attract the necessary capital for additional investment..

Allowing specific charging issues to be dealt with under UNC governance arrangements rather than as part of a wider review will ensure that the wider review is not delayed by issues that are likely to polarise the industry and not be quickly resolved .