

Ofgem Consultation: Gas transmission capacity – proposal to terminate permit arrangements and adjust the revenue earned from permit arrangements for the period 1 April 2013 - 31 March 2015

Consultation Response

Energy UK is the trade association for the energy industry. We represent over 80 members made up of generators and gas and electricity suppliers of all kinds and sizes as well as other businesses operating in the energy industry. Together our members generate more than 90 per cent of the UK's total electricity output, supplying more than 26 million homes and investing in 2012 more than £11 billion in the British economy.

Energy UK welcomes the opportunity to provide comments to Ofgem's consultation, we have previously provided comments¹² on these permit arrangements (also attached).

Whilst Energy UK recognised that a mechanism was required to adjust lead times in the event that reinforcement was required to meet incremental capacity requests, we did not support the permit arrangements as they were introduced, in April 2013. This was because they had the potential to provide a windfall to National Grid, and hence cost to customers, in the event that the permits are not required. This amounts to £32.4 M over two years.

The process was that National Grid was provided with an upfront financial allowance that it may choose to utilise in advance of entry and exit capacity allocation process to extend the lead times for the delivery of incremental capacity should such requests be received. This was a free option for National Grid in that the allowance remained intact if such capacity requests did not materialise. Hence this did not encourage National Grid to act in a commercial manner since it was allowed to manage the lead time risk for no cost without having to assess the likely need for such an extension. In this context permits were signalled to be desirable at exit points where the plant was already operational or the project on hold, this was public knowledge at the time the scheme was introduced. The decision to deploy permits may have been different if there had been a non-refundable option fee associated with the lead time extension whether it was utilised or not. It may also have been the case that any such capacity request could have been met via substitution as there are reasonable levels of un-booked baseline in the south east but there is no real clarity on this and in any event it is understandable that National Grid pursued the lowest possible risk option. This was to utilise a permit to extend the lead time for the delivery of the capacity even if the capacity may ultimately have been delivered by substitution. In addition, given the economic climate at the time and the development of the electricity market capacity mechanism it was unlikely that there would be much, if any, activity

¹ <https://www.ofgem.gov.uk/publications-and-updates/rrio-t1-gas-further-views-sought-implementation-arrangements-relating-treatment-incremental-capacity-and-constraint-management-incentives-open-letter>

² <https://www.ofgem.gov.uk/publications-and-updates/notice-under-section-23-gas-act-extending-permits-arrangements>

requiring investment in the first year or two of the RIIO-T1 period so it is unclear on what basis the allowances were set initially. Industry was reliant on Ofgem to provide an appropriate assessment of this, but it could be argued that the allowances were too generous particularly since customers would ultimately have to fund these if they were not utilised. Alternately it could be argued the allowance was too small since the permits were not sufficient for large scale entry projects as demonstrated by Ofgem's letter of 30 January 2014³ in response to National Grids request under its licence (outside of the permits arrangements) to extend the lead times for the delivery of capacity at LNG import terminals. Overall our view was that the arrangements were not fit for purpose.

At the time we suggested an assessment be made on a case by case basis or an allowance provided with volume / time parameters to avoid the potential for financial windfall but this was not pursued.

A further factor that has extended the length of time that permits needed to be in place has been the length of time Ofgem took to consider UNC modification proposals 452 and 465 to introduce new arrangements for reserving and booking incremental NTS entry and exit capacity. 50 weeks is ten times longer than Ofgem's performance indicator of 5 weeks. This led to the permit arrangements being extended into the second year of the RIIO-T1 period at an additional cost to customers of £13.4M.

Energy UK therefore calls on Ofgem to seek to recover as much of the permits allowances as it legitimately can to reduce the impact on customers arising from its policy decision. However we fully expect National Grid to oppose this since it needs certainty over its allowances in much the same way that commercial organisations seek regulatory certainty.

Energy UK would be happy to discuss these points further, in the first instance please contact Julie Cox, details below.

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[³ <https://www.ofgem.gov.uk/publications-and-updates/lead-times-contractual-delivery-incremental-obligated-entry-capacity-march-2014-quarterly-system-entry-capacity-qsec-auction>]