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UNC678/A/B/C/D/E/F/G/H/I/J: Amendments to Gas Transmission Charging Regime: minded to decision and draft impact assessment

ESB is an independent generator operating Carrington (910 MW) and Corby (401 MW) CCGTs in GB. We are supporting Britain's transition to a low carbon future by investing in flexible and renewable generation assets, including combined cycle gas turbine, wind and biomass technologies. We own 125 MW of onshore wind generation capacity, with over 400 MW in the development pipeline in Britain and investments in the 353 MW Galloper and 450 MW Neart na Gaoithe offshore wind projects. ESB also owns and operates a 40 MW waste wood-fired generation plant at Tilbury in Essex. ESB is a pioneer in electric mobility and is currently working in partnership with Transport for London to install, operate, maintain and commercialise charging infrastructure for the London taxi fleet. In 2017 we entered the GB energy supply market as ESB Energy.

ESB Generation & Trading welcomes the opportunity to respond to Ofgem's minded-to decision on amendments to the gas transmission charging regime. Our answers to the specific questions and overall comments are provided below.

Question 1: What is your view of our assessment that Postage Stamp is a more appropriate RPM in light of the circumstances of the GB network?

In responding to this question, please address, in particular, the following points in your response:

- **(i) in a meshed network with spare capacity and declining usage, a fair approach to cost recovery would be based on the level of access to the system irrespective of individual location; and**
- (ii) **CWD may introduce signals for use of the network which discourage flows at more distant entry and exit points, without improving network efficiency.**

Both Postage Stamp and CWD are cost allocation mechanisms, and do not reflect the cost-reflectivity aims of TAR NC. ESB GT has previously submitted a view that CWD carries more relevance to this aim, as it incorporates distance and capacity in calculations.[1] However only pseudo-locational signals can be provided by CWD. ACER has indicated in its TAR NC

[1] https://gasgov-mst-files.s3.eu-west-1.amazonaws.com/s3fs-public/ggf/book/2019-05/Representation%200678%20-%20ESB.pdf

reviews of national proposals that it views CWD as a more cost reflective, and preferred, option in the context of Article 7 and seeks justification for use of Postage Stamp in its place (e.g. on the grounds of CWD complexity in a market). The question from ACER's perspective is therefore whether the specific GB situation justifies the use of the Postage Stamp methodology.

The GB NTS is very different in structure to other mature, meshed networks, such as the Netherlands: it contains long distances due to the elongated geography of the country and high capacities at points located at its extremities. We noted at Workgroup for UNC621, and in previous responses during the tariff reform process, that the possibility of incorporating only realistic combinations of entry and exit points is provided for in TAR NC as relevant flow scenarios.[2] This option was not explored in either the UNC621 or UNC678 processes due to time and resource capacity for analysis, so it is unknown whether this approach may have provided a CWD outcome that avoided Ofgem's concerns about high tariffs and discouragement of flows at more distant points. CWD as a methodology may not be the issue so much as its application in this case.

We recognise that the CWD modelling presented with UNC678 showed disproportionately high entry tariffs at St Fergus and high entry/exit tariff combinations at some locations over short distances. The potential impacts of this would indeed be to incentivise redirection of flows to elsewhere on the system, increased wholesale and end-user gas prices, and closure or relocation of industrial and power plant.

Postage Stamp creates a cross-subsidy between users, effectively socialising the cost of the network. Compared to the current charging regime, some network users will benefit with lower tariffs while others do not. But all users will indeed contribute to cost recovery on the basis of their access to, rather than use of, the system. Currently this appears reasonable, as a lack of locational signals may be justifiable where spare capacity is plentiful across the system; Ofgem references at paragraph 4.110 the effective historical and continued use of capacity substitution within the PARCA process. This may change in future, especially given the uncertainties of the future energy transition, potential for new entry point developments of different types and technology, and changes in system usage. Neither CWD nor Postage Stamp as presented in the proposals would prevent future inefficient network investment decisions.

Question 2: Do you agree with our assessment that maintaining the FCC methodology in the UNC improves the transparency and consistency of governance compared to maintaining the FCC Methodology outside of the UNC?

ESB GT previously responded with concerns about the proposed FCC governance and the FCC methodology itself. Incorporating the FCC into the UNC would resolve certain issues around revision, consultation and process (with the caveat that the BEIS/Ofgem Codes Review could lead to changes in code governance and industry's role in change processes). Open and transparent code governance should prevent instability of the FCC itself. We

[2] COMMISSION REGULATION (EU) 2017/460 of 16 March 2017 establishing a network code on harmonised transmission tariff structures for gas, Article 8. 1 (c).

suggest that methodological concerns are addressed ahead of incorporation in the UNC if possible. We note the fundamental disagreement between industry and National Grid on the transparency of the forecast used as input to the FCC (referred to in our UNC678 response), our observations around booking behaviours trending towards flows, and CEPA's observations about the use of historical capacity bookings to forecast future bookings.[3]

Question 3: What is your view on our assessment that the PS RPM would be preferable to the CWD for future green gas market entrants?

ESB GT notes Ofgem's reference to CRU's decision on transmission tariffs for biogas entry points. We do not consider this to be relevant to the GB charging methodology decision. Firstly, the Republic of Ireland estimates high levels of future biogas penetration across the system, which would require many facilities to be connected at transmission level. This scale of major development in biomethane is seen as unique to Ireland and its resource availability for biogas production (e.g. agriculture, population density) in specific locations. We do not believe that widespread biomethane injection at transmission level is foreseen in GB. Secondly, the "*predictability and stability*" of tariffs at entry points is in relation to seeking removal of locational signals for this category of producers. Locational signals have purposefully been made strong in the RoI matrix tariff methodology. In the case of biomethane, CRU was concerned that locational tariffs may disadvantage some projects over others, leading to inefficiencies and lost opportunities for carbon reductions in the very early years of the new industry, while government policy on biomethane support is being developed. ESB GT believes that the transportation tariff regime is not the route to provide policy support.

As mentioned above in our response to Question 1, market developments may lead to a need to promote efficient investment in the future.

Question 4: What are your views on our assessment of the quantitative analysis?

We agree with Ofgem's statement at paragraph 5.10 that caution needs to be applied when drawing conclusions from the results. We note also the comments at paragraph 5.72:

"*In addition to the impacts on consumers, CEPA estimated the effects on the revenues of market participants. Given a lack of accurate cost information, CEPA noted that their estimates are based on a number of assumptions and so, should be considered indicative.*"

It is normal to include caveats with modelling; the above, combined with several other statements in the Ofgem and CEPA documents, and the assumptions used (as we understand them), suggest that the outputs of the quantitative analysis are unlikely to be helpful in any assessment of the proposals.

ESB GT has many concerns about the quantitative analysis and is disappointed that there has been insufficient time to address these: written questions were requested 7 January 2020 and submitted for CEPA 13 January 2020. Written responses from CEPA, many of which are inconclusive, were published 14 February, just five full working days prior to the consultation

[3] CEPA report, Table 2.3.

deadline. There has been no further opportunity to engage on the analysis nor any further detail provided.

Given that Ofgem itself appears to deprioritise the importance of the quantitative analysis, we briefly highlight below only a few examples of our concerns:

Power modelling

Ofgem is reassured that both UNC678 and UNC678A appear to have positive consumer welfare benefits. A large portion of this is due to decreased wholesale gas prices, which, the analysis finds, will offset an increase in gas transportation charges and thus result in lower electricity prices to end-users as well as lower gas prices. There are several issues here, for example, from the power generation perspective:

- The assumption that power generators have perfect foresight and can book capacity precisely for the gas they need to flow, thus always achieving their lowest possible gas transportation costs. Particularly in a period of increased renewables penetration and greater unpredictability of running, this assumption is clearly flawed and sensitivities around it should be considered.

- There is acknowledgement that there may be some over-estimation of the electricity consumer welfare benefit due to a lack of capacity market modelling, and generators may seek to recover lost margin from the capacity market. While the ability of generators to recover lost revenues from the capacity market is not considered or analysed, CEPA's assessment is that the "*impact is likely to be limited*".

- The mixture of aggregation and disaggregation of the gas-fired fleet for NOC modelling casts doubt on the outputs of the power generation modelling. It is unclear how the marginal plant can be identified when modelling the aggregated fleet, with its widely varying age, efficiency, location, ramp rate and other characteristics. Or how closure decision outputs can be derived. A specific example here is the use of Off-peak capacity, which may be critical to the cost viability of some power stations, but not when viewed across the entire fleet.

Moffat interconnector

It is clear that the analysis around the Moffat exit point to Ireland, Northern Ireland and the Isle of Man is confused and inappropriate and may lead to skewed outcomes. Treating the unidirectional, non-merchant interconnector similarly to IUK and BBL is inappropriate. Doing so simply for reasons of consistency with the use of a global gas market model makes no sense; the Moffat exit point is more rationally treated as demand and has been historically in the FES. Treatment of Moffat as a merchant pipeline may lead to unrealistic outcomes. Stating that the "*Irish gas price*" (we assume that the Republic of Ireland is meant here) will be lower than the NBP price by mistakenly excluding the pancaking of transportation charges is also inaccurate and misleading.

Question 5: What are your views on our assessment of the modification options presented to us against the applicable UNC objectives?

Objective d: Ofgem discusses the unjustified exemptions from RRCs under proposals C/E/F/G/H as introducing some form of dual regime. It is unclear in this context how exemptions from RRCs for existing contracts do not also constitute a dual regime, which can impact on competition.

Objective g: ESB GT disagrees that the UNC678I does not satisfy the requirements of Article 9 (2) of TAR NC. Ofgem provides no reasoning for this conclusion. The Moffat interconnector was built specifically to end the isolation of Member States, including part of the United Kingdom. Continuation of gas flows to the Republic of Ireland, Northern Ireland and the Isle of Man and security of supply to small end users may be impacted by the increase in gas costs due to transportation (see our response to UNC678). Ofgem states that the Irish Security Discount gives rise to "*undue discrimination*" at paragraph 6.30, and yet describes the impact on other tariffs as "*muted*" at paragraph 5.44.

Question 6: What are your views on our conclusion that only two modifications - UNC678 and UNC678A - are compliant with the relevant legislation? If you disagree, please provide a fully reasoned explanation.

All proposers considered their Modification proposals to be compliant with TAR NC and provided supporting information. We are not able to comment on the differences of legal opinion between some parties' advisers and Ofgem's advisers.

As stated at Question 5 above we have concerns over the treatment of existing contracts under UNC678/UNC678A and also disagree with Ofgem's conclusion on UNC678I.

Question 7

a) **Given our conclusion that only two modifications are compliant with the relevant legislation, what are your views on our minded-to decision to approve UNC678A rather than UNC678?**
b) **Do you consider our minded-to decision to appropriately reflect the principles based assessment and quantitative analysis presented in this report?**
c) **Do you agree it best facilitates the relevant objectives?**

Please fully justify your response.

a) See response to Question 1.

b) The quantitative analysis suggests that UNC678 (CWD) provides the greater consumer welfare benefit, albeit relatively marginal against UNC678A. As outlined in our response to Question 4 above, the caveats to and lack of value being placed in the quantitative analysis appears reflected in the minded-to decision.

c) See response to Questions 5 and 6.

Question 8: What are your views on our assessment that the proposed RPM (PS under UNC678A) achieves, inter alia, the following objectives:

a) **enables network users to reproduce the calculation of reference prices and their accurate forecast;**

See our comments on the FCC in response to Question 2. Calculations for the Postage Stamp methodology should be simpler than for CWD, where FCC for each individual point is critical to the tariff at each point. Postage Stamp aggregates the FCC, so any issues with the inputs are smeared across all points. This can still lead to unpredictability and volatility of charges year on year.

b) **presents a better option than CWD for the recovery of the costs of the gas transmission system in the presence of a meshed network characterised by spare capacity and declining usage, and where cost-reflectivity is less relevant;**

See our response to Question 1.

c) **ensures non-discrimination and prevents undue cross-subsidisation (you may refer to the results of NGGT's Cost Allocation Assessment ("CAA") published as a subsidiary document to this consultation);**

Postage Stamp is intrinsically a cross-subsidy methodology, as not all users cause the same costs to transmission services. As in our response to Question 1, we broadly agree that the current situation, a mature network with spare capacity, appears to lead to the cross-subsidy being due rather than undue.

Our response to Question 5 outlines concerns that existing contracts will benefit from cross-subsidy from new capacity purchases at entry.

d) **ensures that significant volume risk related particularly to transports across an entry-exit system is not assigned to final customers within that entry-exit system;**

National Grid's CAA for 678A supports this.

e) **ensures that the resulting reference prices do not distort cross-border trade?**

Uniform entry and exit tariffs at all IPs should not result in distortion of cross border trade. The step change in tariffs from the change in regime may impact trading flows and gas sourcing decisions. We anticipate an impact on the wholesale price of gas in Ireland as the island's marginal source of gas is Moffat.

Question 9: What are your views on our minded-to decision that implementation should take place from 1 October 2020 to coincide with the start of that gas year?

We support implementation from 1 October, as the start of the Gas Year. This start date is also compliant with CAM timelines for publications and auctions at IPs.

In our view implementation from 1 October 2021 has strong benefits. Firstly the new charging regime would coincide with the beginning of the RIIO-GT2 price control period, allowing for

greater certainty of revenues and preventing spill over of any k factor or other adjustment from one Price Control to the next. Secondly, there would be adequate time to develop solutions for shorthaul, storage discounts and incorporation of the FCC into the UNC, all of which are suggested by Ofgem in its minded-to decision. Thirdly, we are concerned that there will be insufficient notice of the new charges for October 2020. Ofgem's forward work plan states that the timeline for an Authority decision runs to September. National Grid has stated that it will commence calculations of FCC and charges only once the final decision is made. Any legal challenge or ACER query could lead to further delay. It may be prudent to consider 1 October 2021 for the new tariff regime to become effective.

Question 10: Are there any other matters, whether or not addressed in our analysis or minded-to findings, which you think we should take into account in reaching our final determination?

We are concerned that the issue of the Moffat interconnector being infrastructure to end the isolation of gas system has not been given due consideration. The quantitative analysis models Moffat in a wholly unsatisfactory manner. The lack of inclusion of UREGNI at footnote 4 (p. 10) may be an oversight, but we consider that Northern Ireland as a gas market wholly reliant on supplies of gas via Moffat, an isolated system apart from the SNIP connection and part of the United Kingdom, should be taken into account.

Ofgem should be mindful of publication timelines and the impacts on commercial arrangements and systems, at wholesale and retail level. Tariff regime change causes significant disruption, and while a change has been anticipated for some time, the lack of certainty of the final outcomes mean that commercial operations carry additional risk.

Overall comments

We understand Ofgem's reasoning for the selection of the Postage Stamp methodology. We consider that it is reasonable to apply Postage Stamp in current market circumstances, but reflect that this is a time of uncertainty and potentially radical transition for the gas system. Locational signals may grow in importance as network use changes and new production sources enter the market.

We are concerned that the quantitative analysis outputs should not be relied on due to the assumptions and constraints used in the modelling. In some cases, the approach used is flawed and the results, and resulting statements, are misleading to the reader. The power generation sector impacts are under-estimated in our view and we believe it is possible that the change in gas charging regime will play a part in closure decisions.

We fundamentally disagree that the island of Ireland, and Northern Ireland in particular, do not meet the criteria for being considered isolated gas systems connected via the Moffat interconnector. Ofgem's reasoning on this issue would be welcomed.

Strong consideration should be given to charges becoming effective from 1 October 2021. This would coincide with National Grid's price control under RIIO2, allow sufficient time for

development of solutions to shorthaul, storage and the incorporation of the FCC methodology into the UNC, and ensure there is sufficient notice of charging is provided.