



St Lawrence House
Station Approach
Horley
Surrey
RH6 9HJ

Office of Gas and Electricity Markets
10 South Colonnade
Canary Wharf
London
E14 4PU
By email to RIIO2@ofgem.go.uk

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Dear Jonathan

NTS exit capacity incentive consultation.

SGN welcomes the opportunity to respond to the NTS Exit Capacity Incentive^[1]. As you may be aware, SGN manages the network that distributes natural and green gas to homes and businesses across Scotland and the South of England. We deliver a safe, secure and reliable gas supply to 5.9 million customers through 74,000km of pipeline.

In our GD2 business plan, we have set out an ambitious set of customer and environmental outcomes which we have discussed extensively with our stakeholders and customers. For each of these we have explicitly set out in a transparent manner the additional outputs that we propose to deliver in GD2 and the required investment, each of these have been tested these with our customers.

Whilst clearly setting out each of our outputs we have also recognised where there is uncertainty and have proposed uncertainty mechanisms that are in customers' interests where we have limited control on either the costs of the workload requirements to provide an adaptive package able to respond to changes in policy and create the right balance of risk between networks and their customers.

We remain of the view that appropriately designed incentives work in the best interests of our customers by introducing a management focus on delivering a desirable change in business practices. To this end, we have proposed a social value collaboration incentive that promotes collaboration across utilities in reducing roadwork disruption. This incentive is appropriately calibrated according to the social benefit delivered and the additional costs to be incurred.

It is our view that in GD-1 the NTS exist capacity incentive was also appropriately targeted at driving the right behaviours to ensure an efficient booking of capacity on the National Transmission System (NTS). The more efficient booking has now become engrained as management practices and the marginal benefits associate with continued improvements are reduced.

As we move into RIIO-GD2 and beyond we recognise the challenges and uncertainty ahead on the road to the decarbonisation of heat and the respective role of electricity and gas networks in delivering this.

There is a great deal of interest at the current time from companies wishing to connect to the gas networks in order to generate electricity. Whilst we do not make assumptions on the level of connections other than those currently accepted on to our networks, based on the level of enquiries we have received it could transpire that any decrease in our peak demand forecasts from general efficiency improvements are outweighed by demands of power generating plant thus resulting in a net increase in peak demand during RIIO-GD2. We also recognise that it is important to ensure that consumers are protected and will continue to diligently forecast demand and economically book capacity to protect security of supply whilst limiting the cost to our consumers. We do note that competition for capacity in certain areas appears to be ever more increasing and have experienced a loss of baseline capacity in our own networks as a result of exit substitution to support growth in the power generation sector in other locations on the NTS.

We also recognise that, whilst the existing incentive is based on the assumption that exit capacity prices reflect spare capacity, this will cease to work in this way once UNC0678 is implemented. As such there would be limited price signals to indicate spare capacity and aid decision making for efficient capacity bookings.

As such we are supportive of Ofgem's proposed position of removing the incentive rather than putting significant focus on redesigning a structure that potentially delivers limited consumer benefits.

Finally, we would like to affirm our continued commitment to supporting the efficient and economic operation of the gas transmission and distribution networks and will continue to work co-operatively with National Grid Gas in doing so for the benefit of UK gas consumers.

Should you require any further information with regards to our response then please do not hesitate to contact me at David.Handley@SGN.co.uk

Yours sincerely,

David Handley
Head of Regulation
SGN

CONSIDERATIONS FOR INCENTIVISING EFFICIENT NTS EXIT CAPACITY BOOKINGS.

Question 1. What specific GDN behaviours should any future exit capacity incentive mechanism seek to drive and what consumer benefit would these deliver?

We believe that it is in the best interest of UK consumers for effective and reliable capacity signals to be provided so that appropriate investment can be made, and efficiencies delivered. More efficient network planning and capacity planning reduces both the operational cost of and avoids unnecessary capital investment. Currently, however there is a significant change in the market, with Mod 678 being introduced, and as such we think that it is too early to confidently align an incentive base price signal with an optimal market outcome.

Question 2. Can you provide evidence of specific actions taken by GDNs in response to the RIIO-GD1 NTS exit capacity incentive and set out how these have delivered lasting benefits to consumers?

During GD1 we have worked closely with our colleagues in National Grid Gas (NGG), the operators of the NTS, to support them in managing their network as efficiently as possible whilst maintaining the appropriate level of capacity bookings to meeting our legal obligations to supply gas during the 1-in-20 peak demand period.

We can confirm that we will continue to be committed to supporting the efficient and economic operation of the gas transmission and distribution networks and will continue to work co-operatively with NGG in doing so for the benefit of UK gas consumers.

Question 3. Do you agree with the considerations we've identified, and the issues associated with them?

Broadly, however, it is important to note that where the consultation document refers to the level of spare capacity, that this is not the case on an uninformed basis. There are very tight constraints in some areas of the network which need to be considered, particularly in those areas that have an unserved demand (Scotland) or localised areas of high growth (Southern).

Secondly, the consultation document raises the persistence of improvements made in the booking system should remain in place in GD2. We agree with this statement, however, it is important to recognise that the system is not static and that we may need to respond to increased demands placed on our network if there is a significant increase in flexible generation, or peaking plant, as a result of price signals in the electricity market.

Question 4. Are there any considerations beyond those we've identified that we should take into account for incentivising exit capacity bookings in RIIO-GD2?

It is very important to have a clear understanding as to what an efficient level of booking is. Currently, the CEPA paper does not attempt to define an efficiency which is important for consideration of any future design or structures.

OPTIONS AND INITIAL THINKING FOR RIIO-GD2

Question 5. Do you agree with the options that CEPA has identified and in what other should we consider for GD2?

CEPA's options broadly cover the range of options that could be considered. It has not however considered a direct negotiation between the distribution network and the transmission network, particularly when it comes to operational management of the interface between NGG and the GDN.

Secondly, during GD2, there has been significant discussion about whole system approaches and ensuring that the correct signals are in place to ensure the most appropriate allocation of investment and resources across the network. Whilst this will not be deliverable in the timeline that for RIIO-GD2, it is important to be considering this wider strategic approach and alignment with the electricity networks.

Question 6. Which of the options presented by CEPA is your preference for RIIO-GD2 and why?

We agree with the assessment that has been carried out by CEPA that the options presented would either be too time consuming to introduce or would not lead to an appropriate calibration of incentives. Given the feedback that we have received from stakeholders on the NTS exit incentive we do not think that leaving it unchanged is appropriate.

Question 7. If we remove the existing incentive mechanism without any mitigations how should these be managed?

We do not consider the risks of removing the existing incentive to be that material. We negotiate with NGG on a regular basis about the capacity that we require to meet our annual demand. That demand is set out and publicly available for comments through the long-term development statement. As we progress into GD2 we have proposed a re-opener around any capacity reinforcement on the >2bar network (with volume drivers on the <2bar network) and as a result of this reopener, we anticipate that there will be a high level of transparency surrounding any additional capacity that we are requesting from NGG.

Question 8. If we remove the existing incentive mechanism what enhanced obligations could we consider introducing for RIIO GD2 that would effectively maintain GDN booking constraint?

Again we need to be careful about introducing complexity where it is not needed. We support the need for transparency and would consider the existing long term development statement and existing RRP as appropriate places for this reporting.

The CEPA paper also raises the option of putting procedures into licence rather than the existing UNC process. We think that this would be inappropriate as it would risk constraining the interactions between networks and provide a block towards delivering whole-system solutions.