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27th March 2020

WWU response to Ofgem's consultation regarding RIIO-GD2 NTS Exit Capacity Incentive

Dear Network Price Controls,

Thank you for the opportunity to respond to this consultation. Wales & West Utilities is a gas transporter serving 2.5 million supply points in Wales and south west England. We are responding to this consultation because it has a direct impact on the operation of our networks, the efficiency of the total gas system and resulting prices for our customers.

In summary, and consistently with information provided in our RIIO2 Business Plan, we believe this incentive should continue. We would add that our preference from the options presented by CEPA would be option 3.1 whereby actual prices are used in the calculation.

Further information to the full set of questions is provided at the end of this letter.

Our response need not be treated as confidential.

If you wish to discuss this response further please contact either Bethan Winter (System Operations Manager) Bethan.Winter@wwutilities.co.uk or Smitha.Coughlan (Pricing Manager) Smitha.Coughlan@wwutilities.co.uk

Steve Edwards
Director of Regulation
Wales & West Utilities
WWU Detailed Response:

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

It is beneficial to all Users that GDNs are encouraged to book only the NTS capacity needed to meet our 1:20 licence condition. This minimises costs to consumers, frees up NTS exit capacity for others and reduces risk of over-investment on the NTS.

Future incentives should promote optimisation of the Total System. Transmission and Distribution should be encouraged to work together so that bookings (and ultimately flows) can be moved to support the most efficient operation of the Total System (T and D). This should minimise consumer costs and, through optimisation of NTS' compressors, support our net zero ambitions.

Any future incentive should also seek to minimise the potential for there to be 'winners and losers' as a result of timing of cashflows or geographical / structural differences.

There is a potential risk that in the absence of an incentive; and with Exit Capacity costs being passed to consumers, GDN's may reduce focus in this area; book conservatively at every offtake and pass costs to consumers. This would reduce NTS capacity availability for other NTS Users and could result in unnecessary investment on the NTS.

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

Specific actions taken during GD1 fall into three key areas.

We have reduced bookings where we are able to do so:

We have moved our flows to cheaper offtakes where we could do so. This reduces costs to customers. However, the tree and branch structure of most of our LDZ networks means there has been limited opportunity for us to do this. During this period, we have also seen significant growth in the connection of flexible generation which in some cases has made it necessary for us to increase our bookings.
Lasting benefits: Our current and enduring bookings are at the correct levels to meet projected 1:20 demand which ensure reliable and efficient supplies to our customers.

The process has encouraged dialogue and productive engagement between NTS and GDNs:
We undertake significant dialogue with NTS about bookings as part of annual planning processes. We have also looked to improve industry processes in this area via feedback to exit capacity methodology consultations and more recently via UNC Mod 671 in which we looked at ways in which booking processes could be made more efficient. This modification has been withdrawn and the issues will now be considered as part of the wider NTS Capacity Access Review UNC Mod 0705R.
Lasting benefits: Improvements to booking arrangements will benefit our consumers and other NTS Users, ensuring fair access to NTS capacity.

We have held NTS to account over prices at our exit points:

Our goal is to ensure the NTS costs passed on to our connected customers are reflective of the costs incurred by the NTS. We have therefore played a leading role in the development of the NTS charging models to ensure a fait outcome for all customers across GB.

Lasting benefits: A sustainable and cost reflective charging framework that is fair to all NTS customers.

It should be noted that the benefits to consumers in the future may be impacted by the charging methodology adopted by NTS.

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

Exit Capacity Pricing:
We agree that a postage stamp methodology would see a fundamental change in the approach to bookings in the absence of alternative incentives. It is likely that GDNs would move to book capacity at the locations that are most efficient for their network operation. This might have an adverse impact on the efficiency of the Total System.

Levels of spare capacity
In our parts of the network most requests for NTS Flex have been rejected in the last few years. This had led us to believe that capacity is limited in the areas in which we operate.

Reward / Penalty calibration – We agree that at an aggregate level, arrangements for NTS to recover costs limit the impact of our capacity incentive on current prices for consumers. However, the action of miminising our NTS bookings means that NTS investment should be minimised and so the amount of revenue they need in the longer term should be efficiency. At the moment the sharing factor is applied to any incentive. Any changes to the sharing percentage will impact the strength of the incentive.

Persistence of improvements – See comments above on exist capacity pricing.
Going forward we need a stable and predictable pricing methodology from NTS that means all GDNs and their customers have equal opportunity to benefit based on performance. The consultation suggests that all GDNs have received substantial rewards under the current incentive. It is worth noting that the differential between the largest incentive reward (Cadent) and the lowest (WWU) for the first five years of RIIO GD1 (CEPA report Table 2.1) is over £60m.

The CEPA report also states that "the reduction in actual NTS exit capacity costs relative to the target seems to be driven by lower NTS exit capacity prices than forecast, largely due to lower revenue requirements by NGGT which has the effect of reducing prices across all exit points". This is not the case for WWU in all years, in fact for the 17/18 gas year, actual prices were in some cases over 50% higher than T-3 indicatives. The current system whereby T-3 indicative prices are used in the incentive calculation therefore creates a risk of there being winners and losers.

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?

We would suggest the following could be considered:

1. Aggregate GDN bookings are in part a response to demand change within networks which is not within our control
2. We already share offtake flow information with NTS under Section H of the UNC for a range of demand levels which could be used as a performance measure

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3. The current commercial arrangements such as User Commitment reduce our ability to reduce bookings and the outcome of the NTS Capacity Access Review (raised as part of our response to question 2) process may change these and / or other aspects of current arrangements
4. Revenue under / over recovery will impact GDN prices following the change in methodology, whereas previously it didn't. This may introduce additional risks to DNs such as increased volatility and predictability of prices.

Question 5 – Do you agree with the options CEPA has identified, and if not, what others should we consider for RIIO-GD2?

An incentive around the accuracy of information shared between GDNs and NTS under Section H of the Offtake Arrangement Document could be considered.

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

The RIIO framework is there to incentivise networks to deliver efficient outcomes for stakeholders. We believe this incentive should continue and is consistent with this principle, but under option 3.1 whereby actual prices are used in the calculation rather than T-3 indicatives.

Question 7 - If we remove the existing incentive mechanism without any mitigations, what are the potential risks and how should these be managed?

There are a number of potential risks to be considered:

1. In this scenario GDNs would not be discouraged from over-booking at an aggregate level which would be advantageous in giving us the most flexibility in how we operate our networks. This would result in increased costs for consumers and inefficient use of the NTS. There could be a negative impact on other NTS Users as NTS capacity becomes less available and increases in the use of NTS compression impacting costs and carbon.

2. Reduced engagement with the NTS on whole system planning may lead to less efficiency in the planning and operation of the Total System

3. If GDNs reduced focus in this area there would be an increased reliance on ofgem and others to scrutinise NTS processes

Please see our answer to question 8 for mitigations.

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 restraint? Please provide any specific examples

More focus could be applied to comparison of GDN capacity bookings against our peak demand forecasts. However, the current booking arrangements and user commitment rules are also a factor here as noted above.

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