

Consultation on Short Term Exit Capacity for Gas Transmission in Northern Ireland

08 June 2023

SGN Natural Gas



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Natural Gas

SGN Natural Gas (SGN NG) welcomes the opportunity to respond to the consultation on Short Term Exit Capacity for Gas Transmission in Northern Ireland.

SGN NG recognise that any decision to implement Short Term Exit Capacity within the Northern Ireland gas market is a particularly complex issue. We also appreciate the arguments set out within this consultation paper and the previous consultation in 2016 which suggest it might be favourable to power generators to implement such a regime, however we are not convinced following review of the analysis provided in the current consultation that the introduction of Short Term Exit Capacity is in the best interest of Northern Ireland gas consumers. We also believe it is likely to have a negative impact on electricity consumers.

It was confirmed in both this consultation and in the previous consultation that a change to the exit capacity regime is not necessary from a gas market perspective and that the proposal to make changes is purely to address concerns raised by generators. Fundamentally SGN NG disagree with the principle that generator concerns about financial viability and competitive disadvantage appear to be being addressed solely through the gas market rather than through the I-SEM or at the very least through a combination of measures within both markets.

It is our understanding that the principal objective of the SEMC is to protect the interests of consumers of electricity wherever appropriate by promoting effective competition between persons engaged in, or in commercial activities connected with the sale or purchase of electricity through the SEM. Therefore, it would seem that this is the most appropriate forum to address generator concerns. It is not apparent from the current consultation that this route has been fully explored as a means to address the concerns of generators, so we would suggest that prior to any changes being made to the gas market that a review of the I-SEM arrangements in relation to this issue should be carried out.

SGN NG also have concerns in relation to the timing of such a change. We do not consider that short term exit capacity products should be introduced at this time. As noted to some extent in the consultation there is a high degree of uncertainty within the electricity and gas markets which introduce challenges in understanding and anticipating the likely resulting effects.

The current consultation paper demonstrates that the introduction of short term capacity products at transmission entry had a significant impact on the volatility of the year end reconciliation, particularly in the years immediately following the introduction. Therefore, it is likely that the same will be true if the products are to be introduced at exit. Given the uncertainty faced in relation to gas volumes and capacity, it does not appear to be the right time to introduce a further layer of uncertainty for gas consumers and gas suppliers, particularly during difficult economic times.

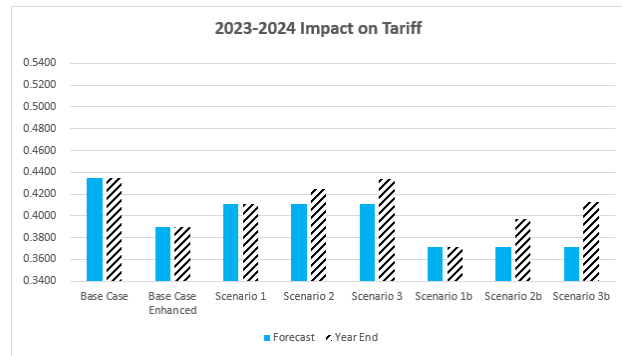
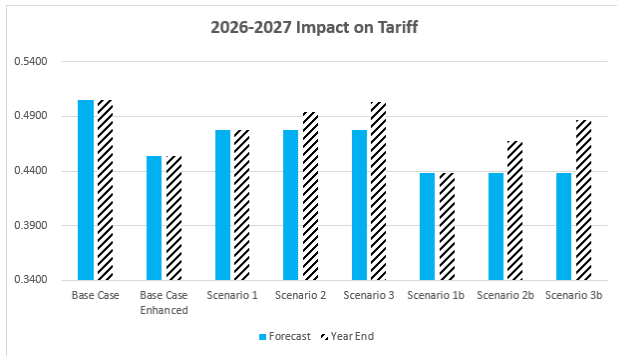
We carried out some analysis based on GMO NI's most recent tariff publication to enhance our understanding of how changes in forecast volumes and capacity might impact the outcomes of the same scenarios which UR presented within the consultation. We comment on this analysis further throughout our response.

Analysis of Gas Year 2026-2027 forecasts

We understand the reasons for UR selecting Gas Year 2023-2024 for use in the analysis carried out to support the consultation process, however, given that this forecast information was provided in early 2022 (and the outlook has significantly changed within the gas distribution sector since that time) we have also looked at the forecast for 2026-2027 provided in the most recent GMO NI tariff publication.

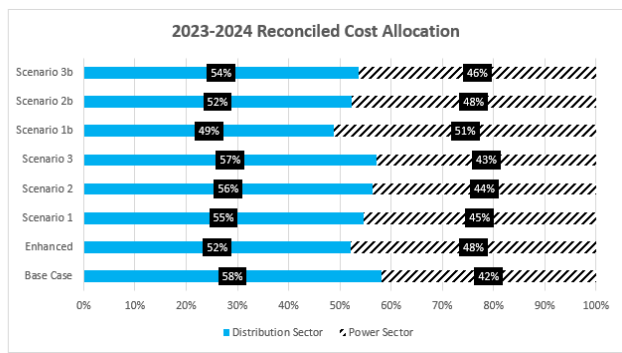
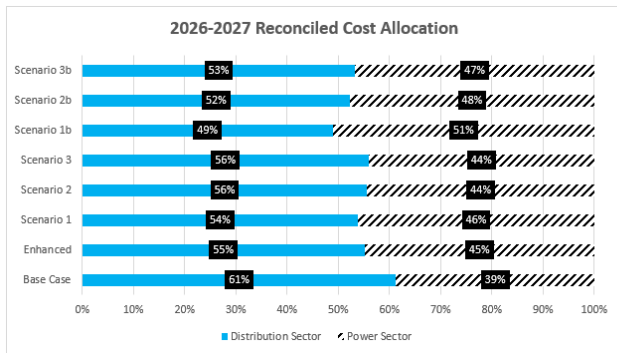
We believe this analysis provides a useful comparison the help demonstrate the uncertainty that is faced when relying on forecast information particularly given the significant changes which are likely to occur both in the gas and electricity sectors in the coming years. The difference between these forecasts in a relatively short period of time demonstrates the rate at which the outlook is changing for both the gas and electricity sectors. We would therefore urge caution when proposing changes to the current regime based on this uncertainty.

Our analysis shows that when the 2026-2027 information is applied to the same scenarios, there are a number of impacts, firstly we note the increase in tariffs:



While we understand that increasing tariffs are a likely result regardless of the implementation of any change, we think this is a useful demonstration of the impact of changes in forecast information prior to adding any additional changes to the mix.

We further note the impact on the proportion of costs recovered from each sector across the various scenarios. As demonstrated in the chart below for many of the scenarios, the distribution sector continues to contribute the greater share of revenue:



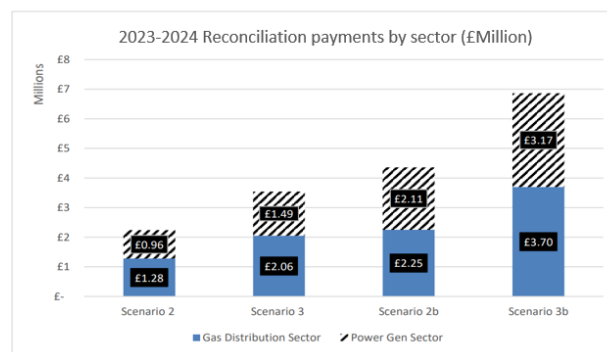
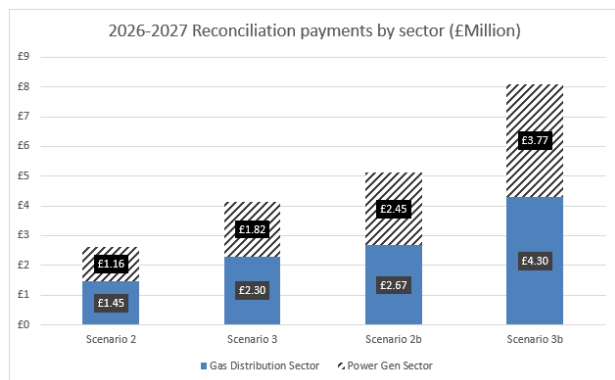
We would again suggest that the implementation of any change will require careful consideration of the impacts which might be felt by the gas distribution sector in the years following any implementation particularly given the influence a change in the regime could have on capacity booking behaviours.

Volatility of end of year reconciliation

The volatility of the year end reconciliation is an ongoing concern for the gas industry. We welcome the increased level of information on forecast amounts provided by the GNOs throughout the gas year to support the industry in planning for this, but this does not negate the significant impact the year-end reconciliation has on gas suppliers and gas consumers. We also recognise the implications of the TSOs; therefore, we believe it is necessary that any changes proposed should aim to reduce the risk of this volatility rather than increase the risk.

Using the UR model and the most recent tariff model forecast data from GMO NI for Gas Year 2026-2027, which provides a more up to date profile of forecast information for each party, we gain a valuable insight into the impact that any changes might have.

The charts below demonstrate the impact on the year-end reconciliation, which becomes much more pronounced when we input this data for Gas Year 2026-2027 to the UR model:



While the UR proposal to introduce measures such as a buffer account may help to reduce this risk, SGN NG believe the impact of the year end reconciliation on Gas Suppliers could also be reduced if the proportion of costs recovered from exit capacity was reduced (and conversely the proportion of costs recovered from entry increased). We suggest that this is something which should be considered regardless of whether short term capacity is introduced.

TSO revenue recovery Entry-Exit split

As mentioned above we believe there is potential to address the year-end volatility with by reviewing the proportion of revenue recovered from entry and exit. If a greater level of TSO revenue was to be recovered through the recovery of entry charges, this would reduce the impact at year-end and might also reduce some of the concerns raised by generators in relation to exit capacity costs.

The UR modelling looked at the current scenario where circa 40% of revenue is recovered from entry and 60% is recovered from exit. In our modelling we look at a 90:10 split and an 80:20 split. Unsurprisingly the results showed that where the proportion of revenue recovered from exit is reduced, so too does the year end reconciliation. For all scenarios we modelled we noted similar trends to the UR modelling. It was also apparent in this scenario that the flattening of the seasonal multiplier resulted in a higher degree of volatility for the year end reconciliation albeit the overall level of reconciliation was reduced.

We therefore recommend that regardless of the introduction of short term capacity at exit, a review of the entry-exit split is something which should be explored as an alternative to the potentially more complex arrangements proposed by UR in terms of introducing a buffer account.

Overrun mechanism to replace the Ratchet mechanism

SGN NG agree with the UR proposal to replace the current ratchet mechanism with an overrun mechanism. Given the potential impact of the current mechanism on gas consumers it would be useful to discuss this area further to understand how the mechanism might change and the implications of implementing such a change.

1 in 20 capacity booking obligation

The requirement to book for a 1 in 20 winter ensures that sufficient capacity is available during periods of extremely high demands whilst also supporting competition between gas suppliers on the NI gas distribution networks. We appreciate that this means that the distribution sector is contributing over-proportionally to capacity bookings, but that this in turn provides a security of supply benefit to gas consumers.

We note URs suggestion that booking short term exit capacity may be an option for the SGN NG network given that it is still in a growth stage, however based on the current requirement to consult with impacted parties on capacity booking proposals and to provide transparency for Gas Suppliers, this option is not feasible based on current arrangements.

We are also mindful of the potential for renewable gases such as Biomethane injection to the SGN NG network in the coming years, which is likely to have a significant impact on the volumes of gas transported through the

transmission system. Therefore, we suggest reviewing the 1 in 20 booking requirement is much more important in this context and should be given the appropriate consideration as part of the decarbonisation workstream instead.

Capacity booking responsibilities

The current capacity booking regime whereby DNO's book and hold capacity on behalf of all gas suppliers on their respective network is the most cost effective and efficient manner in which to do so. It is likely that any change to this regime would place undue burden and additional costs on gas suppliers that is unlikely to provide the equivalent benefit.

Seasonal Multiplier Factors

We reviewed the impact of smoothing seasonal multipliers against both the URs analysis and our own analysis. We note that the URs analysis shows that smoothing the seasonal multiplier factors appears to have a less adverse effect in terms of cost allocation for the gas distribution sector. It may also result in a lower price; however, this also means it heightens the volatility in year-end reconciliation payments for gas suppliers. Our analysis using data for Gas Year 2026-2027 from the recent GMO NI tariff publication confirms this and also shows that the volatility risk is more pronounced where there is a significant variation between forecast and actual.

While we can see the benefit in reducing the tariff across the year for gas suppliers, we do not believe that the positive impact of this reduction outweighs the negative impact on the year-end reconciliation. Therefore, we do not support the proposal to smooth the seasonal multipliers.

Cost Benefit Analysis

SGN NG suggest that prior to any changes being implemented a cost benefit analysis should be carried out. We believe the proposal to implement short term capacity products at exit introduces a further layer of complexity to the gas market, which as noted by UR is not a legal requirement, nor was it deemed appropriate when it was previously consulted on.

The implementation of such a change would require system development to enable the TSOs, DNOs and Gas Suppliers to support these arrangements, there will be a need to address the changes with network codes and it is also likely that there will be a need for additional resources to support the implementation and to manage the ongoing arrangements. The costs for these elements will be borne by NI consumers, therefore we suggest it will be necessary to understand the impact of such costs.

Conclusion

SGN NG do not believe that short term capacity products should be introduced at exit at this time and that careful consideration should be given to making changes to any element of the gas market arrangements.

We have strong concerns in relation to the timing this proposed change. As noted to some extent in the consultation there is a high degree of uncertainty within the electricity and gas markets which introduce challenges in understanding and anticipating the likely resulting effects. Given the high levels of uncertainty in areas such as gas and electricity forecasts, changes in booking behaviour of generators, the impact of the south-north interconnector and that robust forecasts for Kilroot are difficult to forecast, we believe there is a risk that the proposal is seeking to make changes within the market somewhat prematurely as the current uncertainty introduces difficulties in truly understanding the implications for consumers. We acknowledge URs obligations in relation to the protection of consumers and based on the analysis provided within the consultation we do not consider the proposed change to be in the best interest of consumers.

We fundamentally disagree with the principle that generator concerns about financial viability and competitive disadvantage are to be addressed through the gas market. Instead, we suggest that UR should seek to address the concerns being raised by generators through the electricity market in the first instance and only where absolutely necessary look to implementing changes within the gas market.

We also note that there is no legal requirement for short term capacity products at exit in the Northern Ireland gas market and in addition to this the outcome of the 2016 review was that the proposed changes were not considered appropriate. We consider that the decision in relation to this is still appropriate given the limited changes since that time.

In terms of the proposal to smooth seasonal multipliers, we understand that this might introduce some level of benefit as it is likely to result in a lower tariff throughout the Gas Year, however the volatility it is likely to introduce for the year end reconciliation creates a significant negative impact. Therefore, we do not believe the proposal to smooth the seasonal multipliers is the best solution for the NI gas market.