Energy for generations

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Dear Jillian

Consultation on Harmonised Tariffs for Gas Transmission

ESB Generation & Trading (ESB GT) welcomes the opportunity to respond to the above consultation of 21 June 2018, concerning the implementation of TAR NC in Northern Ireland. ESB GT's response is separated into two sections: the first summarises ESB GT's main comments on the consultation and the second part provides answers to the specific consultation questions. ESB GT's views on other key points and the overall consultation are:

- Many references in TAR to cross-border trade refer to transit flows (e.g. Article 5 cost assessment), although distortion to cross-border trade can also been seen in diversion of gas flows to alternative markets. ESB GT believes that this should be considered and cross-border aspects of TAR should not always be dismissed as irrelevant in the Northern Irish context.
- In this context, alignment between NI and RoI for the purpose of non-distortion within SEM/ISEM is highlighted in the consultation document, but applied selectively to specific elements without justification. ESB GT believes that further alignment, or progress towards alignment, can be beneficial to consumers overall and should be examined in more detail (e.g. product availability at Exit).
- The bullet payment method of reconciliation for revenue recovery is mentioned at paragraph 5.11, along with UREGNI's minded-to position not to change it. The current process appears compliant with TAR, but as the Regulation refers specifically to the possibility of a flow-based revenue recovery charge, this may have been relevant for explicit review within one of the questions in this consultation, especially in the context of a change in the capacity:commodity split.

If you require any clarification of our response, please do not hesitate to get in contact.

Yours truly

Kirsty Ingham
Regulation & Commercial Manager, UK, ESB GT

Question 1: We are interested in respondents' views on whether the postalised regime meets the requirements of a Reference Price Methodology, as outlined in paragraph 4.5. Specifically, do respondents consider that the postalised regime enables network users to reproduce the calculation of reference prices and a forecast for future years?

ESB GT agrees that the postalised regime meets the TAR requirements as outlined in Article 7. Point a), concerning reproduction of the calculation and accurate forecasting, is predicated on the accuracy of the forecast parameters themselves. ESB GT is able to reproduce the calculation and forecast on the basis of the published information on GMO's website. ESB GT welcomes the transparency and accessibility of the spreadsheet model and documentation. The methodology is clear and, per point b) of Article 7, appears appropriate to the level of complexity of the transmission system.

ESB GT agrees with the sentiment in paragraphs 4.29 and 4.30, that points c) and d) of Article 7 refer to transit versus domestic flows and are therefore irrelevant for the Northern Irish gas transmission system. However, ESB GT disagrees with paragraph 4.31. Point d) of Article 7, "*ensuring that the resulting prices do not distort cross-border trade*", does not necessarily refer exclusively to transit flows. If transmission cost differences were significant between markets due to varying methodologies and levels of charges, this could incentivise Shippers to flow gas to one destination market over another (i.e. an arbitrage opportunity could emerge from implementation of different regulatory regimes). Additionally this could impact location and operating decisions for large users and connected markets, such as electricity. ESB GT notes that alignment to the RoI tariff system is perceived by UREGNI as necessary for some elements of charging (e.g. multipliers) but not for others (e.g. capacity:commodity split). ESB GT would like to understand more on the reasoning behind these choices.

Question 2: We are interested in the views of respondents about the indicative reference prices provided in Table 2.

The tariffs in Table 2 are listed as ppkWh per day booked, whereas ESB GT understand them to represent capacity charges in £ per (peak day) kWh per annum.

ESB GT notes that these capacity tariffs show a 25% increase on the original 2018/19 forecast in GMO's 2017/18 tariff publication (0.22858 £/kWh/day). This also represents a 29% increase on the 2017/18 tariff level, as outlined in the explanatory note accompanying the most recent tariff forecast. It is apparent from the explanatory note that the increase in tariff is due to a reduction in forecast daily entry capacity

bookings and a £9.5 million year on year increase in WTL forecast required revenue due to project timing (which may change). Forecast exit capacity bookings and volumes both show an increase, while forecast annual entry capacity bookings are stable.

ESB GT has several observations:

- At a time when wholesale energy prices are increasing, such significant increases in transport costs is clearly of concern for the consumer of both gas and electricity. The change to 95:5 capacity:commodity split further amplifies the effect of the increase in transport charges for low load factor users. This amplification would be lessened by a different split (e.g. 90:10) or by introducing the change over time on a sliding scale.
- The forecast decrease in daily capacity booking was based on recent historical bookings at the time of the tariff calculation. It is not clear if the reduction is due to changes in booking behaviour or previous over-forecasting of daily bookings. It may be helpful to understand this better to enhance future forecasting, and adjust the forecast methodology as necessary.
- At the Shipper Forum on 22 August 2018, GMO outlined that the reconciliation payment forecast had reversed from deficit to surplus, with a payment likely due to be made to Shippers. It is not clear if this change in forecast is connected with the daily capacity forecasting made for 2018/19, i.e. that the drop in daily entry bookings was observed during Gas Year 2017/18, and was used for the forecast 2018/19, but the pattern has since reversed. If this is the case, and the forecast appears now to be a less realistic, there could be a large over-recovery and the reconciliation payment may be larger than anticipated. Inflated transmission charges in the short-term would clearly be a concern to all system users.
- The WTL expenditure is stated as dependent on timing and changes in financial market rates. It is not clear if adjustments to the figure have been made for these risks, which may have reduced or increased the forecast required revenue. Large increases in charges for transportation may make the economic case for domestic fuel switching less attractive, and the investment in network extension less viable.

Question 3: We welcome views on our proposal to change the capacity commodity split to 95:5. Are there any other factors regarding this change that we should consider?

As a power generator, a key concern for ESB GT at the present time is the introduction of ISEM scheduled for 1 October 2018. As mentioned at paragraph 5.27, the rules under ISEM will be different and will be in place prior to the implementation

of this proposed change in capacity:commodity split. UREGNI observes that it does not anticipate any significant disadvantage for generators.

ESB GT believes there are several factors to be considered when changing the capacity:commodity split:

1. Peaking plant

At paragraph 5.22, UREGNI asserts that there are two types of customer usage pattern on the system, power generators and gas consumers, with the latter having higher winter peaks and lower summer troughs in consumption. The lower load factor consumer group have a higher ratio of peak to average demand and therefore have greater capacity needs relative to flows.

ESB GT agrees that small end-user gas demand is weather driven and the daily flows result in relatively high capacity bookings. However, power sector gas demand can also be at low load factor, driven by weather, markets and system requirements. Some gas-fired plant already operate in Northern Ireland to cover peaks in electricity demand and do not run at baseload. It is foreseeable that with greater electrification of heat, combined with further growth in variable renewable generation output, running patterns for power plant will change, and load factors and predictability of operations will reduce.

The analysis outlined in 5.20-5.28 is therefore too simplistic and short term in its outlook.

2. Capacity products

The lack of short-term capacity products at Exit means that power plant must purchase annual capacity. Power plant must buy capacity up to their peak demand level and have high levels of redundancy, or purchase a lower level of capacity and enter capacity overruns. Neither approach appears efficient nor least cost to the consumer. The proportionate increase in capacity costs could be managed more efficiently at Exit through short-term and seasonal products, allowed for within TAR and implemented at Entry through CAM.[1] Other markets throughout the European Union, including neighbouring markets, have a wide range of capacity products at

[1] COMMISSION REGULATION (EU) 2017/459 of 16 March 2017 establishing a network code on capacity allocation mechanisms in gas transmission systems and repealing Regulation (EU) No 984/2013

Exit allowing Shippers better to manage their bookings and the change toward the TAR intention of (close to) 100% capacity-based charging.

3. SEM / ISEM

At paragraph 5.27 there is reference to commodity charges being passed through as Short Run Marginal Costs under the Single Electricity Market. Under ISEM, participants can also bid SRMC into the energy market. There is also the Capacity Remuneration Mechanism (CRM), which is designed to ensure that sufficient generation capacity is available at times of system stress. Participants bidding into the competitive auction incorporate costs involved in keeping plant available to generate at any time. Gas capacity costs are relevant, especially when only available as an annual product at Exit. The impacts of the change in capacity: commodity split have not been considered in this context: an increase in capacity costs could cause a change in the position of plant within the CRM auction ranking, which could lead to plant not securing a contract.

Furthermore, plant are bidding into auctions one and four years ahead of delivery. Fundamental changes to gas capacity costs must be transparent and made in a timely manner to support participants in determining their potential costs that need to be factored into their CRM auction offers.

4. Alignment across the island

As pointed out at 5.16, the networks, TSOs and charges are different between Northern Ireland and the Republic of Ireland. This is used as justification not to align NI charging to the 90:10 capacity:commodity split in RoI.

However, at 7.8, it is stated that UREGNI intends to continue to align seasonal multipliers at Entry with those in RoI "*in order to minimise any divergence on the SEM.* […] *to ensure that there is no perverse pricing signal which affects decisions of all-island generators.*"

It is not made clear why alignment is justifiable for multipliers but not the capacity:commodity split. ESB GT has also highlighted above other points where alignment may be beneficial for parties competing on the all island electricity market.

Question 4: We are interested in respondents' views on whether the proposed commodity charge meets the requirements outlined in paragraph 6.2, specifically, that the charge would be set to recover the costs mainly driven by the quantity of gas flows.

Paragraph 6.2 of the consultation document indirectly quotes Article 4.3 (a) (ii) of TAR, stating that the commodity charge should be "*the same at all entry points and exit points*". This would clearly be problematic for Northern Ireland given that under TAR commodity charging cannot be applied at Interconnection Points (IPs), the only Entry point is an IP and currently the commodity charge is only applied at Exit. The text of TAR on closer inspection clarifies that the charge should be "*the same at all entry points and the same at all exit points*" (i.e. the level at entry and exit may differ, but all points in each group must be charged at the same rate). The approach in Northern Ireland therefore appears compliant with TAR.

At paragraph 5.13, the level of compressor fuel costs per the price control is given as 2%, but a maximum of 5% is deemed to be appropriate. It would be useful to understand the sensitivity analysis used to reach the figure of 5% and also to negate the use of 10% (as used in RoI and discussed in paragraph 5.16). It would also be helpful to understand the differences between systems and/or approaches to justify this lack of alignment.

It may be suggested that an alternative approach, taking the annual actual fuel gas charges could be applied, more accurately recovering the costs driven by quantities of gas flowed. The disadvantage would be a potential lack of forward visibility and predictability of the tariffs, as a further parameter would be forecast rather than fixed. Rounding to a stable percentage has the benefits of being understood and stable, even if the revenue figure it is calculated with is not.

Question 5: Do respondents consider that the information published alongside the postalised tariff provides the information listed in paragraph 6.1?

See above response to Question 4 on the justification for the choice of 5%, with reference to Article 26.1 (c) (i) (1) and (2).

Question 6: We welcome respondents' views on whether the services provided by TSOs do include an element of non-transmission services, or should the services continue to be solely classified as transmission services?

ESB GT is not aware at present of services that should be classed as non-transmission services and/or levied against specific system users.

Question 7: We are interested in respondents' experience of the seasonal multiplier factors for non-annual entry capacity in the last two Gas Years.

The availability of within year products at Entry in Northern Ireland and across Europe has been useful to Shippers. The lack of equivalent Exit capacity products presents some limitations. The alignment of multipliers with RoI is welcome, as would be further alignment, as outlined above.

Question 8: We welcome views on the aspects listed in paragraph 7.15, particularly with regard to the balance between facilitating short-term gas trade and providing long term signals for efficient investment in the transmission system. Specifically, do respondents agree with our proposal to maintain alignment with the factors offered in RoI?

The factors listed feature in Article 28 of TAR, concerning discounts, multipliers and seasonal factors. Misalignment of multipliers could result in impacts on cross-border flows, in the sense of diversion to an alternative market rather than transit. As already expressed, the lack of equivalent granularity of products at Exit to Entry limits the potential whole system benefits.

On the question of investment, the needs of the largest user group need to be given significant attention. Large gas users make their own operating and investment decisions on location on a rational economic basis. Without this group, the cost recovery burden from any additional investment would increase significantly for small gas users and be a barrier to fuel switching.

Question 9: We would ask the respondents to share their view as to whether the transmission charges publications outlined in the table above are sufficient to allow Network Users to better understand the transmission tariffs and the costs underlying them, as well as to estimate their potential evolution beyond the current tariff period

Table 6 is very helpful in identifying the various documents and sources intended to be used to meet the conditions of Articles 29 to 30. It is clear that GMO and UREGNI will be responsible for different pieces of information; it would be useful for there to be a single route of access to all the data and a clear timetable for publication.

A key parameter for the estimation of tariff evolution is the forecast of capacity bookings. It is not clear where this information, the methodology behind it and any sensitivities around the main forecast will be located. See also our observations under Question 2.