



**National Grid Gas plc – Conclusions on Operating Margins
Contestability and Initial Thoughts for Associated SO Incentive
Arrangements
Comments from AEP¹**

The Association of Electricity Producers (AEP) welcomes the opportunity to provide comments on this document. We provide our views against specific section headings.

Section 5: Potential OM Service Providers

The Association considers that NG has undertaken a detailed appraisal of the issues in relation to the various potential new OM service providers, which are well summarised in the table in section 5.4.

With respect to the provision of OM from CCGTS we believe NG has identified the physical and contractual processes adequately. With regard to aggregation we would expect shippers to be in the best position to provide a potential aggregation service across more than one CCGT; this is because of the relationship in many cases between the shipper and the power station operator.

We also agree that it would be unwise to book OM provision from CCGTs on the basis of baseload operation, and that some recognition needs to be taken of this when contracting for OM services. The analysis presented in section 5.1.5 is helpful in this respect.

In addition NG is considering how to determine the volume delivered by OM response from a CCGT when its planned offtake is not uniform through the call off period. The obvious option is rightly identified as the OPN as this is the only indication NG has of the future offtake intentions of the CCGT. However utilizing this will commercialise the OPN and be a move away from its original intention. That said as there is greater use of electronic OPN submission the consequences may be limited as operators are already obliged to keep NG informed of changes in expected offtake patterns.

¹ The Association of Electricity Producers (AEP) represents large, medium and small companies accounting for more than 95 per cent of the UK generating capacity, together with a number of businesses that provide equipment and services to the generating industry. Between them, the members embrace all of the generating technologies used commercially in the UK, from coal, gas and nuclear power, to a wide range of renewable energies.

Section 6 – Contracting Principles

This section highlights some of the contracting difficulties that arise from trying to contract for a pre-specified rate change or volume from CCGTs that will have variable load factors and offtake profiles affected by a variety of factors; not least seasonal weather patterns but also prices relative to other fuels particularly coal and electricity market drivers. An individual CCGT nor indeed the whole portfolio of CCGT plant cannot guarantee a certain level of running from one season to the next.

We understand that NG needs to have confidence in the amount of OM that might be available, and acknowledge that NG would have to contract for more volume from CCGTs than it would from storage providers to manage the uncertainty over CCGT running patterns. This was demonstrated by the analysis in Section 5. In this section NG considers that it would look for a minimum reduction of at least 1000MWh/h, this is roughly equivalent to 500MWe. I.e. full load of a 500MW CCGT assuming its running baseload or 77% of a 650MW CCGT. It is not feasible that plant would be routinely running at these levels throughout the year, although these kind of levels may be achievable from a group of CCGTS.

For these reasons we can see practical difficulties on CCGTS setting maximum offtake rates very far a head of real-time. However minimum offtake rates may be more readily set either at zero or at some minimum stable generation level. Perhaps the availability payments should be determined after the day from actual offtake levels minus the minimum rate. However this would be less straight forward if the service provision were to be from a group of CCGTs.

As considered above we think the use of the OPN to determine service volumes provided would be appropriate, the use of FPNs may not be appropriate given that gate closure is only one hour ahead of real-time so that where OM provision is called for more than an hour (as would usually be the case) the FPN would give no indication of the expected offtake for the full duration of the OM service provision. Nor does the FPN detail what efficiency factor should be used to convert from electricity generation to gas offtake or what fuel is being used for generation, in the case where a CCGT switches to backup fuel the FPN would not be helpful in this respect.

With regards to penalties for failing to provide the service we appreciate why these are necessary given NG's safety case obligations. However given the discussion above concerning uncertainties in offtake from CCGTs it is difficult to appreciate how penalties for lack of availability would be reasonable and would not act as a disincentive to offer the service in the first place. Clearly if a CCGT is not offtaking at a certain level the system itself will be under less strain and perhaps there is a lower probability of needing OM. In addition we see this situation being largely analogous to a storage facility that is already withdrawing at a high level for supply / demand reasons in response to shipper nominations when OM is needed. Clearly there is a limit to how much more the storage facility can withdraw when it is already doing all that it can.

Conversely when storage is withdrawing at high rates the system is more likely to be stressed and more likely to require OM support.

We consider it is perhaps more important to focus on penalties for failure to deliver a quantity that is clearly available on the day. I.e. the CCGT fails to turn down or the storage facility fails to turn up. We consider that SMP buy plus the exercise cost of alternative provision may be an option but are concerned that this could create unlimited liabilities which would be unlikely to promote provision of OM from new providers.

Section 7 – Procurement Strategy

The Association appreciates that NG needs some assurance that OM services will be available at short notice when required and therefore that it would be inappropriate to rely entirely on short term procurement options like the locational OCM. We note that NG again raises the point that OM from storage is only unavailable in known circumstances such as when and to the extent that the facility is withdrawing, the level of withdrawals would not be known until dayahead or within day. We see this as entirely analogous to availability from demand side sources only being known in similar timescales, depending on whether the plant is running or not.

However we believe that the locational OCM or some other mechanism² could be used in conjunction with longer term procurement of an option for availability which would require participants to place gas / rate change on the locational OCM or other mechanism when required to do so. Such a process would allow for new providers to receive an option or availability fee in return for providing an offer of a rate reduction when called to do so. Such a process would mean that providers were obliged to provide the service but the actual exercise fee could be determined on the day of use.

Whilst the Association has not undertaken any analysis of possible option / exercise fees, we believe that if CCGTs were required to offer fixed volumes at fixed prices then the risk premia involved in this would make it more difficult for CCGTs to compete with other providers. We appreciate that NG is concerned about possibly facing high prices on a day when OM is called, but we consider to some extent these concerns may be mitigated if the gas released is retained in the shipper portfolio and also by the fact that OM is utilized very infrequently. It would also be the case that any extreme prices would be likely to be subject to regulatory scrutiny.

The Association agrees that the proposed zones are appropriate for assessing locational OM provision.

The Association acknowledges that competition in the provision of OM services may not develop for a variety of reasons, if it does not then there may

² The document notes that there is no established mechanism to procure offtake reduction from CCGTs. However following Ofgem's decision on exit reform such a mechanism may exist and is defined in Annex B-2 of the legal drafting for Mod 195 / 195A

be scope for amending the existing structures and incentives as a greater fraction of the total requirement may be secured from non-LNG storage sites.

Section 8 – SO Incentive Arrangements for OM

The Association agrees that NG should continue to be incentivised to procure OM services efficiently and effectively on behalf of the industry, but that those incentives may need to evolve to reflect the introduction of contestability.

At this time we consider it is a rather 'chicken and egg' situation, should the incentives change before or after the introduction of contestability. We broadly agree that there could be an 'trigger point' at which shippers begin to share the risks and rewards but do not have a clear view on how the trigger point should be defined. We would have some reservations over moving the incentive year to the storage year at a time when provision from non-storage providers is being encouraged given the complexities this could introduce in other areas.

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