Utility Regulator
www.uregni.gov.uk

Short Term Exit Capacity for Gas Transmission in Northern Ireland

Decision paper

2 December 2024

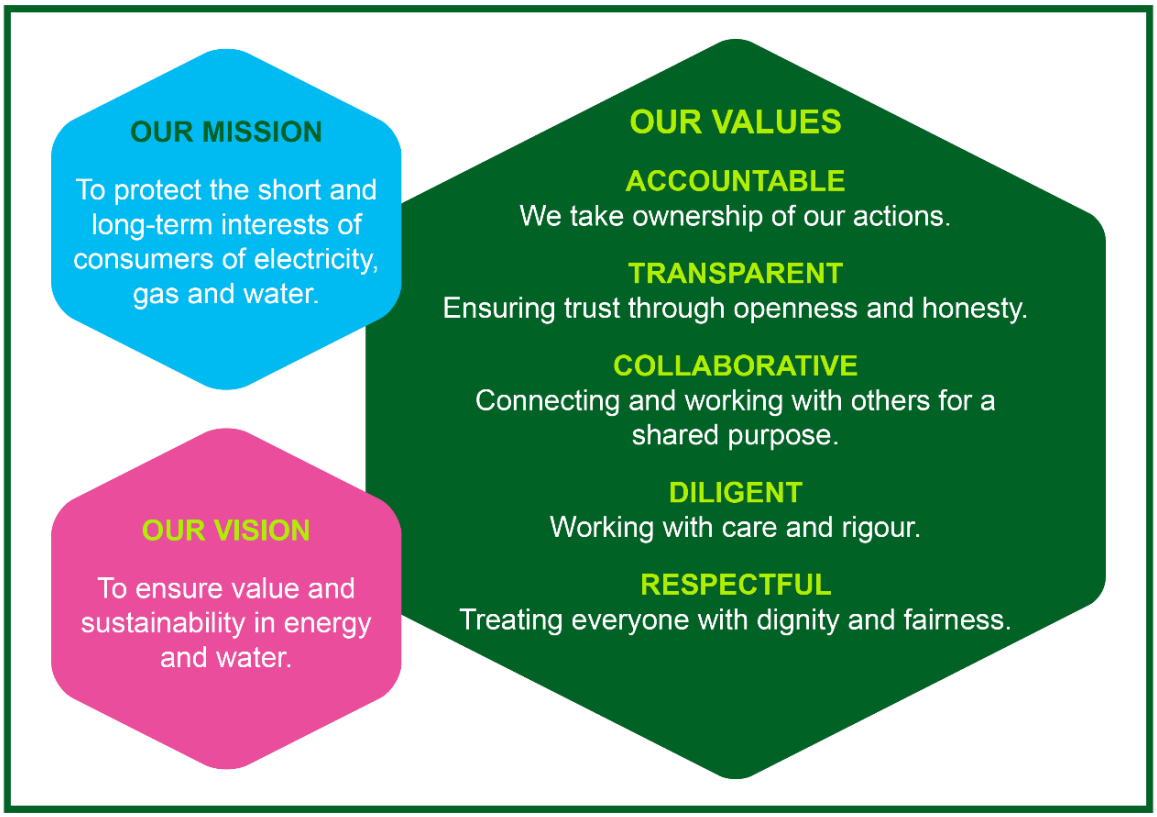
About the Utility Regulator

The Utility Regulator is the independent non-ministerial government department responsible for regulating Northern Ireland's electricity, gas, water and sewerage industries, to promote the short and long-term interests of consumers.

We are not a policy-making department of government, but we make sure that the energy and water utility industries in Northern Ireland are regulated and developed within ministerial policy as set out in our statutory duties.

We are governed by a Board of Directors and are accountable to the Northern Ireland Assembly through financial and annual reporting obligations.

We are based at Queens House in the centre of Belfast. The Chief Executive and two Executive Directors lead teams in each of the main functional areas in the organisation: CEO Office; Price Controls; Networks and Energy Futures; and Markets and Consumer Protection. The staff team includes economists, engineers, accountants, utility specialists, legal advisors and administration professionals.



Abstract

This Decision Paper follows on from the 2023 “Consultation on Short Term Exit Capacity for Gas Transmission in Northern Ireland”. The responses to the consultation indicated that the introduction of short term exit capacity would be beneficial to gas power generators but was likely to result in detriment to gas users. To meet our statutory duties, we have decided not to proceed with introducing short term exit capacity products at this time.

Audience

This document is likely to be of interest to regulated companies in the energy industry, government and other statutory bodies and consumer groups with an interest in the energy industry.

Consumer impact

As our decision is to not proceed with introducing short term exit capacity products, there will be no impact on consumers.

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Executive Summary

In the consultation[1] we sought views on introducing short term capacity products at exit points in the gas transmission regime in Northern Ireland (NI). We recognised that introducing short term exit products would likely benefit the gas-fired power generators in Northern Ireland (NI) who would be able to match their capacity bookings on the gas network with their expected dispatch in the Single Electricity Market (SEM) helping to reduce their costs. We initially considered this could potentially encourage an overall net increase in gas exit capacity bookings which would be beneficial to all gas users.

In response, however, power generators stated their intention to use short term exit capacity to reduce their overall bookings. As demonstrated in the consultation paper scenario analysis, a reduction in bookings by power generators would lead to reallocation of cost to Distribution Network Operators (DNOs) to recover postalised shortfalls at year end. Respondents also indicated that short-term capacity products at exit would be more difficult to forecast than annual capacity products which would lead to further volatility in year-end reconciliations.

Uncertainty in the gas and electricity markets presented challenges for all stakeholders, including UR and our consultants, in determining, with a level of certainty, the impact of introducing short term exit products. However, the majority of respondents recognised the risk of negative implications for non-power generation gas users, particularly gas consumers, and did not support the introduction of short term exit products in NI. We agree that the evidence and analysis provided indicate that short term exit capacity products risk detriment to non-power generation gas users.

Therefore, our decision is not to introduce short term exit products at exit. This decision has been made on the basis of our statutory duties with respect to the exercise of our gas functions[2]. Our principal objective being to "promote the development and maintenance of an efficient, economic and co-ordinated gas industry in Northern Ireland, and to do so in a way that is consistent with the fulfilment by the Authority, of the designated regulatory gas objectives."

We recognise responses from power generators outlining the benefit of greater flexibility in the gas capacity market and seeking alignment with RoI in the SEM, which would both likely benefit the electricity sector. Ultimately, our statutory duties dictate that greater weight should be given to the interests of gas consumers when we are conducting our gas functions. Further, we cannot trade off detriment to gas consumers with benefit to electricity consumers by introducing short term exit

[1] Consultation on short-term exit capacity in the gas transmission system in Northern Ireland | Utility Regulator
[2] in Article 14 of the Energy (Northern Ireland) Order 2003 (the Energy Order). More specifically, pursuant to article 14(1) of the Energy Order

capacity products in NI. We recognise that the status quo does not address the potentially distortionary impact of the gas ratchet mechanism on the SEM. Therefore, we are considering mitigations which should help address these issues.

1. Purpose of this Paper

Subject of the decision paper.

1.1 On 31st March 2023 we published our consultation on Short Term Exit Capacity for Gas Transmission in Northern Ireland[3] to seek views from respondents on the impact of changes to the current exit regime on the gas and electricity industry and NI consumers. The consultation closed on 9th June 2023.

1.2 We posed questions that provided stakeholders with the opportunity to provide views and evidence on potential changes to the current gas exit capacity regime in NI. These included key areas below –

- The merits of introducing short term exit capacity products.
- Gas scenario analysis
- Impact on prices in the SEM
- Ratchet mechanism.
- Cost recovery between power and distribution sectors
- Volatility risks
- 1 in 20 obligation[4] and capacity booking
- Other (secondary transfers, ex-ante entry: exit split, improving gas exit capacity forecasting and any other matters to be considered)

1.3 We asked respondents to identify whether the consequences of introducing short term exit capacity in NI would impact the gas or electricity market/consumers. The consultation was clear that any decision to change the current exit regime in NI, i.e. to introduce short term products at exit, needed to be evidenced based. We received responses from ten respondents.

1.4 In this decision paper we outline how the responses to the consultation and further considerations have led to the conclusion that introducing short term products at exit would have a number of implications and risks for non-power generation gas users. For the purposes of this paper non generation gas

[3] Consultation on short-term exit capacity in the gas transmission system in Northern Ireland
[4] Licence obligation on DNOs to book sufficient gas exit capacity to meet daily firm demand exceeded only in 1 year out of 20 years. See: FEDL Licence for the Conveyance of Gas in NI 2019 Condition 2.12

users refers to gas consumers, gas suppliers and gas distribution network operators (DNOs).

2. Legal and Regulatory Framework

2.1 As stated in the consultation paper there is no legal requirement to introduce short term capacity products at gas transmission exit points. Therefore, any decision to do so must further our principal objective (for gas) having regard to our statutory duties for gas, which include the need to protect the interests of gas consumers.

UR Statutory Duties

2.2 Our principal objective and statutory duties with respect to the exercise of our gas functions are set out in Article 14 of the Energy (Northern Ireland) Order 2003 (the Energy Order)[5].

2.3 More specifically, pursuant to article 14(1) of the Energy Order, our principal objective is to "*promote the development and maintenance of an efficient, economic and co-ordinated gas industry in Northern Ireland, and to do so in a way that is consistent with the fulfilment by the Authority, of the designated regulatory gas objectives.*"[6]

2.4 Article 14(2) of the Energy Order provides that the Authority shall carry out its gas functions in the manner which it considers is best calculated to further the principal objective, having regard, amongst other things, to

- the need to ensure a high level of protection of the interests of consumers of gas;
- the need to secure that licence holders are able to finance the activities which are the subject of obligations imposed by or under Part II of the Gas Order or this Order;
- the need to protect the interests of gas licence holders in respect of the prices at which, and the other terms on which, any services are provided by one gas licence holder to another.

2.5 Subject to this, the Authority shall, pursuant to Article 14(5), carry out its functions in the manner which it considers is best calculated to, amongst other things:

- promote the efficient use of gas and efficiency and economy in the conveyance, storage or supply of gas;
- secure a diverse, viable and environmentally sustainable long-term

[5] www.legislation.gov.uk
[6] For a definition of designated regulatory gas objectives, see Electricity and Gas etc. (Amendment etc.) (EU Exit) Regulations 2019, Article 128.

energy supply; and

- facilitate competition between persons whose activities consist of or include storing, supplying or participating in the conveyance of gas.

2.6 The UR has a separate principal objective and statutory duties for electricity under Article 12 of the Energy Order.

2.7 Article 14(4) provides that, in carrying out any gas function, the UR may have regard to the interests of consumers of electricity. This may be relevant, for example, if there are two policy options with equal benefit to the gas industry, but one also has some benefits to electricity consumers, it would be possible to choose between them by favouring the one which had this collateral benefit.

2.8 However, as our duties on electricity and gas are separate, there is no provision for us to consider this matter, which involves the exercise of gas functions, "in the round" by trading off the interests of gas consumers against those of electricity consumers. This means that if the introduction of short term products is not in the interests of gas consumers, our considerations should stop there.

2.9 In this Decision Paper (paragraph 5.1) we outline our options assessment of the impact of short term exit products on our ability to meet key objectives in protecting the interests of non-power generation gas users, giving due consideration to the responses received to the consultation.

Regulatory framework

2.10 The broader regulatory and legislative context in which exit regime reform is to be considered includes gas licence provisions on postalisation and recovery of gas TSO allowed revenues. These provide:

a) That Gas Transmission System Operator (TSO) allowed revenue recovery is assured as outlined in Condition 2A.2 of the gas conveyance licences[7] under Postalised Charges.

b) That revenue recovery is delivered in a timely manner and consistent with the mutualised approach that delivers low overall costs to NI energy consumers.

c) The legislative requirement for a common tariff for gas transmission, as explained in the following paragraphs.

2.11 The principle of postalisation for gas transmission charges was approved by

[7] Premier Transmission Limited Gas Conveyance Licence.pdf – used as an example.

the NI Executive and Assembly in September 2001 and was implemented in NI on 1 October 2004. Postalisation means that the charge for transporting (conveying) gas through designated transmission pipelines will be the same irrespective of where the gas is offtaken for final use.

2.12 Pipelines subject to the common (i.e. the postalised) tariff are designated by Department for the Economy (DfE) under article 59 of the Energy Order and include all the high pressure pipelines in NI.

2.13 Article 14(2)(c) of the Energy Order provides that UR shall carry out its functions in the manner which it considers is best calculated to further the principal objective, having regard to:

> *14(2)(c) the need to secure that the prices charged in connection with the conveyance of gas through designated pipe-lines (within the meaning of Article 59) are in accordance with a common tariff which does not distinguish (whether directly or indirectly) between different parts of Northern Ireland or the extent of use of any pipe-line;".*

2.14 Currently, the transmission tariff methodology results in the same reference price[8] at all entry points and exit points. It is therefore compatible with the common tariff requirement. The reference price is then used to calculate the tariffs for each non- annual entry product by applying the relevant product multiplier.

2.15 The reference price methodology was reviewed by UR in 2018[9] following a periodic consultation[10] as required by Article 27 of the Tariff Network Code. (TAR NC)[11], subsequently transposed in UK legislation[12] following EU Exit. The transmission tariff methodology applied meets the obligations for application as set out in Article 6 of the TAR NC[13]. Specifically, Article 6 (3) states:

> *The same reference price methodology shall be applied to all entry and exit points in a given entry-exit system subject to the exceptions set out in Articles 10 and 11.*

2.16 Additionally, Article 6(4b) of the TAR NC states:

> *Equalisation by the transmission system operator(s) or the national regulatory authority, as decided by the national regulatory authority, whereby the same reference price is applied to some or all points within a homogeneous group of points.*

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[8] The reference price refers to the price for the annual capacity product for applicable entry and exit points derived in accordance with the methodology which determines cost allocation between different points in the transmission network. UR has adopted a 'postage stamp' methodology.

[9] Decision Paper - Harmonised Gas Transmission Tariffs (uregni.gov.uk)
[10] Consultation on Harmonised Transmission Tariffs for Gas
[11] Commission Regulation (EU) 2017/460 Article 27 (legislation.gov.uk)
[12] https://www.legislation.gov.uk/uksi/2019/531/data.pdf (page 45)
[13] Commission Regulation (EU) 2017/460 Article 6 (legislation.gov.uk)

2.1 The obligations set in the TAR NC for application are met by UR in the current transmission tariff methodology.

3. Responses to the Consultation

3.1 We received responses to our consultation paper from ten respondents[14]. We appointed an external consultant to assist us in assessing those responses, specifically to test if the responses provided sufficient evidence for the points being made. One response was subsequently withdrawn, leaving nine responses, as follows:

- Consumer Council Northern Ireland (CCNI)
- Gas Networks Ireland UK (GNI UK)
- Gas Market Operator Northern Ireland (GMO NI)
- Mutual Energy (MEL)
- Electricity Association of Ireland (EAI)
- Evolve (previously known as SGN NG)
- firmus energy
- Phoenix Energy
- ESB Generation and Trading (ESB GT)

Overview of responses from gas Distribution Network Operators (DNOs).

3.2 The DNOs opposed the introduction of short term exit capacity products in NI. They were not convinced the introduction of such products would be in the best interest of NI gas consumers and could lead to volatility and an increased contribution of revenue from the distribution sector. They contested DNOs would be unable to use short term exit capacity products without the removal of the 1 in 20 obligation.

3.3 One DNO stressed that a move to short term capacity products would require significantly increased administration, possible requirement to use the Prisma system and could also result in increased credit support costs.

3.4 DNOs outlined their current difficulties in recouping under recoveries and reimbursement of over recoveries through gas suppliers in a changing customer base due to switching.

3.5 With regards to the energy transition one respondent emphasised the

[14] One respondent (confidential) subsequently withdraw its response.

significant role DNOs will play in developing plans such as biomethane. Acknowledging that increased energy efficiency will lead to less volumes in the gas network to allocate postalised charges, the DNOs state that "fairness" in allocation of the costs is important.

Overview of responses from the power generation sector.

3.6 Responses from the power generation sector mostly supported the introduction of short-term gas exit capacity in NI. They stated that short term products would promote security of supply and investment in NI.

3.7 There was support for alignment and a "level playing field" with the RoI gas transmission regime which offers a range of short-term exit capacity products.

3.8 Generators stated that the introduction of such products could allow conventional generators to align their booking of exit capacity with their running profile. They envisage a changing role of conventional generation as a back up to renewable generation when resource availability is low and note their expectation that utilisation factors for gas fired power generation will fall. They add that aligning exit capacity bookings to the periods when they are required to maintain secure operation would support efficient operation of the electricity system by ensuring appropriate pricing signals are relayed to electricity system operators.

3.9 Power generators raised that, under the current rules, they are unable to include the costs of annual exit capacity products in Balancing Market offers in the SEM. The introduction of short term exit capacity products would allow generators the potential to reflect these transmission charges, as marginal costs, in their offers to the market.

Overview of responses from gas Transmission System Operators (TSOs).

3.10 The TSOs are generally agnostic to the introduction of short term exit products but indicate that short-term exit products do not seem well suited to the distribution sector in NI.

3.11 While supportive of all-island alignment, they share the concern for potential implications and risk for the non-power generation gas users. One operator noted that introducing short term exit products in NI could have a fundamental impact for the cashflows of the gas TSOs, putting at risk its ability to ensure sufficient incoming cashflow to meet debt obligations. They also noted that annual products provide investment signals to Transmission System Operators (TSOs), albeit imperfect ones.

3.12 Another operator noted that the magnitude of under/over recoveries are likely to be more than the figure in the analysis, therefore the magnitude of reconciliations of short term exit products is likely to be greater than the values shown in the modelling. They added that large reconciliation payments would represent cashflow challenges for shippers as they are not aligned to the timing of resetting consumer tariffs.

3.13 Annual capacity products, it states, lend themselves to stability of transporters revenue recovery and that the use of short term products would inevitably lead to volatility.

4. Considerations

4.1 We commissioned an external consultant to independently review[15] the responses to the questions posed in the consultation. The consultant assessed the responses on the robustness of the arguments, whether these arguments have been supported by evidence, and, where necessary, carried out supporting analysis. In this section we will outline our key considerations incorporating the work carried out by the consultant in assessing the responses and further analysis undertaken.

4.2 In the consultation[16] we outlined the changing need for gas capacity by gas-fired generators as they increasingly move to support renewable generation rather than provide base-load generation. We acknowledged however, that the introduction of short term exit products could have number of potential implications and risk particularly for non-power generation gas users. As required under our current legislative vires, we considered primarily the potential of impact to gas users in line with our statutory duties.

4.3 Our initial considerations were that introducing short term exit capacity products could potentially increase the overall capacity booked at exit points with power generators benefiting from a mix of annual capacity supplemented with short term capacity in line with their projected running profile. We considered this could lead to increased investment in new power generation projects in NI as generators would be on an equal footing to generators in RoI in terms of the range of available products at exit points. We envisaged that this could lead an overall increase in exit capacity which would reduce capacity costs for all shippers.

4.4 However, the responses we received from power generators outlined their intention to use short term exit capacity to reduce their bookings as they expect the utilisation factors for conventional generation in NI to fall. They expressed that in the future the role of power generation is expected to move away from baseload operation to a more flexible load profile and provision of peaking generation. The implication would be that gas generators may prefer short term exit products as it allows them to book capacity on a more granular level and avoid paying for capacity during periods where they are not being utilised.

4.5 Responses from power generators did not indicate an intention to bid more volume into the market as a result of increased flexibility.

[15] We are unable to publish this assessment as one of the responses was subsequently withdrawn.
[16] https://www.uregni.gov.uk/news-centre/consultation-short-term-exit-capacity-gas-transmission-system-northern-ireland

Scenario Analysis

4.6 In the consultation we explored a number of worked scenarios and asked for respondents' views on the results. We considered the impact of introducing short term exit capacity on the postalised tariff, cost allocation between power and distribution shippers and year end reconciliations.

4.7 Our key assumptions from the outset of the gas scenario analysis were:

a) Additional capacity, if booked, should lead to reduction in gas transmission tariffs, other things remaining equal, regardless of whether the additional capacity is an annual or a short term product.

b) Inaccurate short term exit capacity forecasting would have an impact on the year end reconciliations.

c) The proportion of the revenue recovery from DNOs' capacity bookings may change as a result of the power sector increasing or decreasing their capacity booking through the use of additional flexibility.

4.8 Respondents to the consultation generally agreed with the consultation scenario assumptions and recognised the difficulty in determining with any further accuracy the likely outcomes of introducing short term exit capacity to the gas markets.

4.9 We asked respondents to provide us with further information to help us refine the scenarios and assess the case for change so that our final decision would be based on the most robust evidence available. In particular we sought insight from power generators on how they intend to book short term exit capacity. However, the feedback we received is that it is difficult for power generators to forecast accurately given that they are dispatched by SONI at short notice.

4.10 One respondent noted several initiatives in the power sector that are currently in development that will significantly impact the gas system utilisation by power generators. These include planned changes to system inertia by the electricity TSOs and the commissioning of the North-South Interconnector, both of which it states will reduce the reliance on conventional generation. The upcoming changes in the industry landscape present further challenges in developing scenarios which reflect accurate future running profiles of power generators in order to assess the impact of introducing short term exit capacity.

4.11 This made our considerations more challenging as we outlined in our consultation document any decision to change the current exit regime in NI needed to be clearly evidenced.

4.12 The following scenario analysis was presented in the consultation.

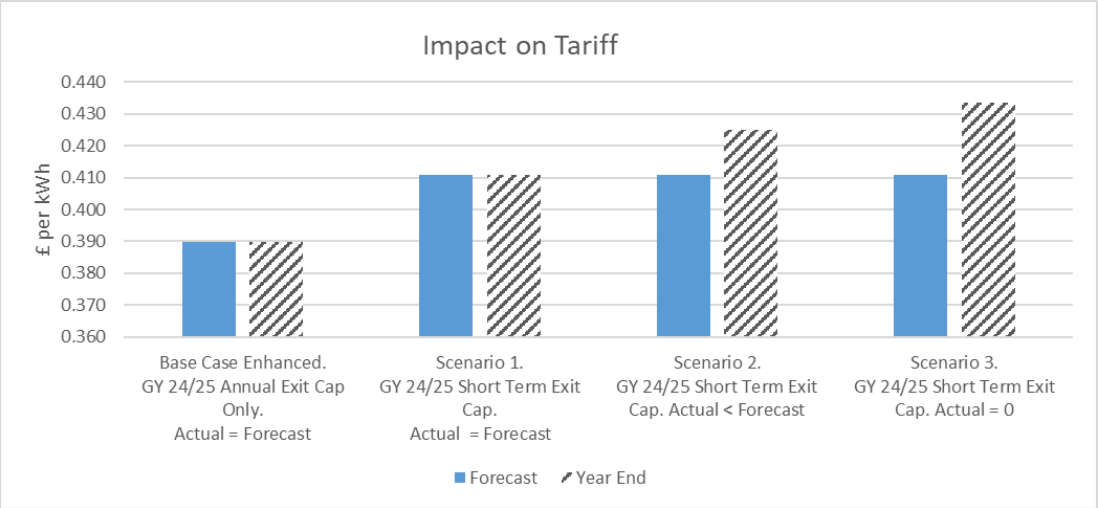

Figure 1

Tariffs

4.13 In Figure 1, taken from the consultation paper, we demonstrated that if power generators use the additional flexibility of short term products, introduced in scenario one, to better align their capacity booking with their running profile, overall exit capacity bookings would reduce and the tariff would increase.

4.14 Moreover, should there be a difference in forecast and actual bookings by power generators, as displayed in scenarios 2 and 3, the tariff gets adjusted at year-end. The impact of this adjustment is that a proportionate share of the year-end reconciliation and bullet payments will need to be recovered from distribution sector, even if they forecast accurately.

4.15 DNOs confirmed in their responses that they are unlikely to use short term exit capacity as they are legally obliged to pay for their peak exit capacity due to the 1 in 20 booking obligation to ensure security of supply. DNOs also expressed that suppliers are unlikely to be supportive of DNOs making decisions regarding short term exit capacity on their behalf.

4.16 This disparity, combined with the difficulty power generators have in accurately forecasting their use of short-term capacity[17] creates the likelihood of cost re-allocations between the power and distribution sectors and increased volatility in the gas transmission tariff at exit.

4.17 Moreover, GMO NI presented evidence indicating that short-term products at

[17] One respondent to the consultation stated, the running profiles and booking requirements for new peaker plants and existing gas units is uncertain and relies on a number of variables.

exit are likely to be more difficult to forecast than annual products. Figure 2 below demonstrates the variation in accuracy in forecasting for daily, monthly and quarterly products at entry points over recent years (percentage difference between actual and forecast capacity).

Source: GMO analysis

Figure 2

4.18 We considered that smoothing seasonal multipliers may result in lower transmission exit capacity tariffs, but our analysis showed that the benefit is negated by larger year end reconciliation payments.

Cost Allocation

4.19 Figure 3 below, taken from the consultation paper, highlights the potential of cost reallocation in the postalised payments should the capacity booked by power generators reduce with the introduction of short term capacity in scenario one. In scenario 1, the distribution sector would contribute a greater share of revenue with the introduction of short term exit capacity in order to fulfil the postalised payment to the gas market operator.

Scenarios 2 and 3 represent the potential further impact on exit capacity cost allocation should power generators forecast to use short term products but not book the capacity leading to under recoveries at the end of the gas year

and increased reconciliation payments.

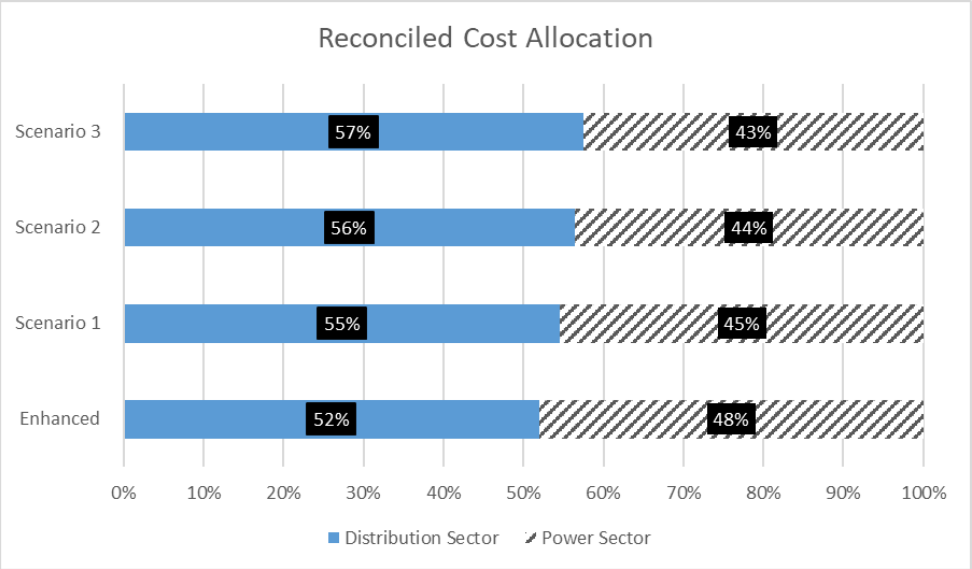

Figure 3

4.20 GNI (UK) noted in its response that any potential impact on revenue volatility should be minimised. Therefore, it added, accurate forecasting for short term exit capacity is critical to ensure that any increase to the volatility for the year-end reconciliation is minimised. It stated its concern for the potential implications and risks for non-power generation users. It added that from a customer perspective any redistribution of costs from the power sector to the distribution sector should be kept to a minimum. The Consumer Council NI echoed this sentiment, stating that a significant swing in cost allocation should prompt a review of the tariff methodology.

Volatility

4.21 The impact of introducing short-term exit capacity products on the volatility of year-end reconciliation payments was a key concern for a number of respondents. Evolve commissioned consultancy support for further analysis on its impact on behalf of the DNOs. The analysis utilised the model used in the consultation scenario analysis, which was updated with tariff model forecast data from GMO NI for Gas Year 2026-2027. Compared to the gas scenario analysis presented in the consultation paper this analysis estimated a greater impact on the end-year reconciliations. Firmus energy expressed similar concerns and referred to the same modelling throughout its report.

4.22 Phoenix Energy also outlined its concerns on the impact of end-year reconciliation. It noted that short-term exit capacity products would be utilised by gas fired peaking plants dispatched at short notice by SONI to supplement renewable generation and would therefore be increasingly difficult to forecast.

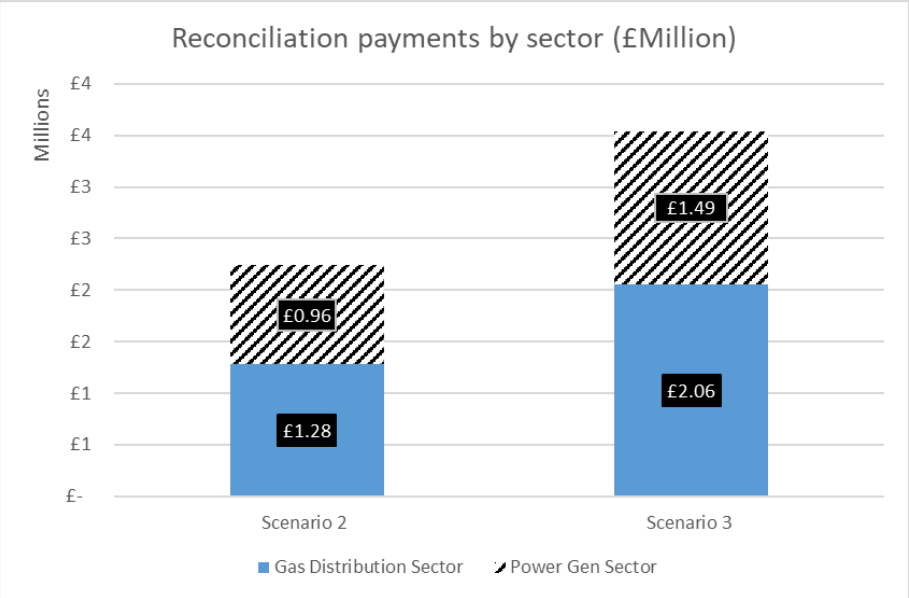

Figure 4

4.23 Figure 4 illustrated the potential volatility in the overall year-end reconciliation should the introduction of short term exit products lead to a reduction in the total capacity forecast actually being utilised by power generators. In scenario two and scenario three the exit capacity booked by DNOs is constant, but the exit capacity forecast by power generators in advance of the gas year is not booked. This demonstrates the potential level of under recovery of postalised gas exit capacity charges at year end.

4.24 In both these scenarios the year-end reconciliation increases for distribution shippers leading to higher year-end settlement payments being required from gas suppliers and potential of increased volatility in consumer tariffs.

4.25 DNOs responded that volatility, such as that demonstrated in Figure 4, makes it difficult for suppliers to recoup end of year under-recoveries or reimburse end of year over-recoveries presented as a bullet reconciliation. Suppliers face a changing customer base due to switching which adds difficulty in fairly administering reconciliations to customers. Respondents also stated that such changes that increase volatility of annual reconciliation payments are detrimental to suppliers and consumers.

Other Considerations

4.26 The DNOs contend that change to the exit capacity regime is not necessary from a gas market perspective and is purely to address concerns raised by generators. Evolve disagrees with the principle that generator concerns about financial viability and competitive disadvantage can be addressed solely through the gas market rather than SEM or a combination of both.

4.27 MEL raised that overall, the total cost of the gas network is not decreasing in

line with generator demand reduction, meaning TSOs will still need to recover costs accordingly.

4.28 Additionally, MEL noted that it sees potential need for network developments to meet the increasing gas requirements of the power generation sector going forward as the energy transition picks up pace and more electrification is required. This may require additional spending on the network which is primarily for the benefit of power stations.

4.29 MEL noted annual products provide investment signals to TSOs, albeit imperfect ones. Removing the requirement to book annual removes these long-term investment signals. In contrast, the introduction of short-term products could prevent these “advanced warnings” from emerging and congestion may appear with as short a notice as a day.

4.30 In terms of TSO revenue there could be an elevated risk of instability due to this increased year-end volatility. MEL states that the introduction of short term exit capacity would increase the risk of cashflow issues as it reduces the guarantee of having a monthly income stream from annual products. The threat of under-recoveries may lead to collateral requirements for shippers needing to be increased. GMO NI suggested that large reconciliation payments associated with volatility may present cashflow challenges for shippers

4.31 In terms of administration of short term exit capacity, the responses indicated that such a regime change would be difficult to introduce in NI. Phoenix Energy notes that implementation would incur additional costs for GMO NI to facilitate arrangements and upgrade systems with unwelcome costs to NI consumers.

4.32 The DNOs expressed concerns in relation to the timing of such a change. As noted above, and 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 of introducing short term exit products.

Impact on the capacity market – Consultant’s Report

4.33 In the consultant’s report, it was indicated that the introduction of short-term exit products would likely remove the competitive distortion between generators in the RoI and NI, and stated that this has the potential to reduce some of the market prices in the SEM.

4.34 It stated that access to short-term exit capacity products would allow generators to book capacity more in line with generation, reducing procurement of annual products, which could reduce costs passed through

into capacity market bids. It pointed specifically to the risk premium embedded into capacity market bids due to the uncertainty associated with having to forecast four years ahead for T-4 auctions.

4.35 However, the consultant concluded, materiality of any impact is hard to estimate (and not included in the consultation responses), especially given that outcomes are uncertain. Additionally, the materiality of any price decrease is likely to be limited by the market share of generation in NI. Further, part of the price decrease in the capacity market could be offset by an increase in balancing or wholesale market prices, as short-term exit products allow generators to reflect exit capacity costs in their offer prices in these markets.

4.36 The consultant also noted that responses provide no further evidence that supports the notion that short term exit capacity would significantly impact generator finance ability, investment in new generation in Northern Ireland, or network costs.

5. Decision

5.1 With the intention of coming to a decision, we conducted an options appraisal to assess options against objectives.

5.2 We considered that there were three options which available to us:

a) Decline to introduce short term products (i.e. maintain status quo)

b) Decline to introduce short term products but introduce mitigations.

c) Introduce short term products and introduce mitigations.

5.3 We address below whether introducing short term exit capacity in NI would achieve certain objectives -

Ensure a fair allocation of costs between power and distribution sectors.

5.4 As outlined in our considerations, responses indicated that the power generation sector expected to reduce their capacity bookings should short term exit capacity products become available. Our scenario analysis indicates that such a reduction would increase tariffs to be recovered from all gas users in order to fulfil the postalised payment required to be paid to the gas market operator and would shift cost allocation towards the distribution sector.

Ensure stability in tariffs and reduce volatility in the year-end reconciliation.

5.5 The power sector respondents indicated they would use the flexibility offered by short term products to align their booking of exit capacity with their running profile, which is becoming less predictable with more renewables on the system. We conclude that the introduction of short-term exit products is likely to reduce stability of tariffs and increase the volatility of end-year reconciliation. This would have a negative impact to gas suppliers and consumers.

Maintain stability in TSO revenue recovery.

5.6 Our considerations and responses to the consultation suggested that there could be an elevated risk of instability in TSO revenue recovery if short term products increased year end volatility. It also presents a further risk – that larger reconciliation payments could result in non-payment, and collateral requirements for shippers may need to be increased to ensure shippers have sufficient liquidity to make a bullet payment in the case of an under-recovery.

Charges at exit reflect the recovery of the costs of peak capacity.

5.7 Finally, this change could represent a move away from exit capacity charges being reflective of the recovery of the costs of peak capacity which could be considered fundamental to the current postalised regime in place in NI.

In summary

5.8 In the consultation, we set out the potential benefits of introducing short term exit capacity products, by encouraging a net increase in capacity bookings. We also set out the potential risks particularly for non-power generation gas users in introducing short term exit capacity products in NI. We outlined that the new products could have impacts on other gas users and that impact had to be carefully considered giving the example of the possible redistribution of costs from the power to the distribution sector and increased volatility in the year end reconciliation.

5.9 The majority of respondents stated their concerns about the negative implications for non-power generation gas users, particularly gas consumers, and did not support the introduction of short term exit products in NI.

5.10 Power generators stated their intention to use short term exit capacity to reduce their bookings as they expected the utilisation factors for conventional generation in NI to fall. No respondents indicated that they would increase their capacity bookings as a result of having short term products available at exit as we had initially envisaged. As evidenced, in our scenario analysis, such a reduction in exit capacity bookings by power generators would lead to increased costs to be recovered from the distribution sector.

5.11 Our analysis further demonstrated that increased volatility, which would likely increase with short term exit capacity, would lead to DNOs funding a greater portion of payments to recover postalised shortfalls at year end. Respondents stated their concerns that issues in recovering increased monies from suppliers could impact TSO stability.

5.12 Additionally, responses indicated that short-term products at exit are likely to be more difficult for power stations to forecast than annual products given that they are dispatched by SONI outside of their control.

5.13 DNOs stated that they are highly unlikely to avail of short term exit products mainly due to the 1 in 20 obligation, but also due to administration costs and their view that suppliers may not wish DNOs to make bookings on their behalf.

5.14 On a wider scale the upcoming changes in the industry landscape presented

challenges for all stakeholders in developing scenarios with any further accuracy in order to determine the likely outcome of introducing short term exit products.

Conclusion

5.15 We conclude that the evidence and analysis provided indicate that short term exit capacity products do not meet our four objectives, and all things considered are likely to be detrimental to gas consumers, specifically non-power generation gas users.

5.16 We also recognise responses from power generation outlining the benefit of greater flexibility in the gas capacity market and seeking alignment with RoI in the SEM, which are both likely to benefit the electricity sector.

5.17 However, our statutory duties dictate that greater weight should be given to the interests of gas consumers when we are conducting our gas functions. Further, we cannot trade off detriment to gas consumers with benefit to electricity consumers by introducing short term exit capacity in NI.

5.18 We recognise that the status quo does not address the potentially distortionary impact of the gas ratchet mechanism on the SEM. Therefore, we will continue to consider mitigations which should help address these issues and this is explored in the following section.

5.19 Our decision is therefore not to introduce short term products but introduce mitigations, Option (ii).

6. Mitigations

6.1 We considered the responses to the consultation as well as working with consultants and GMO NI to assess the suitability of a number of mitigations outlined below.

6.2 We are considering the practicalities of the mitigations and as such these are still being worked up at this stage.

6.3 The mitigations that we considered are listed and explained further below.

a) Mitigations – being considered

(i) A requirement on all shippers to book at least some annual exit capacity ahead of the Gas Year.

A mandate to make annual gas capacity bookings could potentially be introduced to reduce the likelihood of triggering of the ratchet[18] during the year due to very low capacity booking at the start of the gas year. The mandate could be based on a proportion of either forecast exit capacity, actual capacity in the previous year, or by reference to the gas capacity required to meet any electricity capacity contracts held under the Capacity Remuneration Mechanism (CRM) in the SEM.

An obligation for DNOs to book exit capacity on a 1 in 20 basis is already in place in conveyance licences.

(ii) Potential changes to how gas capacity costs are recovered and paid for by generators. This mitigation is outside the scope of this report and is not considered further in the paper

b) Mitigations – ruled out

We considered a number of further mitigations which were subsequently ruled out, at this time, and are briefly outlined below. The key reasons were that the mechanisms were either too difficult and/ or expensive to implement and administer, they are not aligned the postalised NI regime, and/or that they do not sufficiently address the issues in the SEM caused by the ratchet.

(i) Forecast accuracy mechanism.

[18] The ratchet is triggered when a shipper uses more exit capacity than they had booked and it "ratchets" up the shipper's annual capacity booking to the new, higher level. The shipper will be charged for the additional capacity back to the start of the gas year in their next invoice and their future monthly invoices will increase to reflect the new booking.

(ii) Buffer account

(iii) Smoothing seasonal multipliers:

(iv) Moving to an ex-ante entry exit split:

(v) Removing the 1 in 20 obligation

(vi) Replacing the ratchet with an overrun mechanism

7. Next Steps

7.1 We will continue to engage with the relevant stakeholders on the proposed mitigations.