

Stuart Cook
Senior Partner, Smarter Grids and Governance
The Office of Gas and Electricity Markets
9 Millbank
London SW1P 3GE

BD/COM/FG/10-071

Project.TransmiT@ofgem.gov.uk

3rd November 2010

Dear Stuart

Project TransmiT: A Call for Evidence

Thank you for this early opportunity to comment on the scope and priorities for the review; I confirm that our response is not confidential.

As one of the largest UKCS operators, in terms of production and reserves, we have considerable experience of the existing gas transmission charging arrangements through our roles as producer, St Fergus Terminal operator and NTS shipper. With regards to Project TransmiT and this particular Call for Evidence, we deliberately restrict our response to the topic of gas charging arrangements: we believe that this area remains in urgent need of reform and that direction is needed from Ofgem regarding the appropriate principles to apply to future transportation charges.

Specifically, we provide evidence and views on:

- " - Whether the principles on which the current charges are derived remain fit for purpose given the new and emerging challenges that the energy sector faces. If not, evidence of why this is the case and suggestion of what alternative or additional principles should be adopted;
- Whether there are particular issues associated with transmission charging that should be prioritised."

Together with the Transmission System Operator and other major NTS shippers we have, during the past few years, repeatedly raised and evidenced our concerns over the growing inadequacies of the existing NTS entry charge setting arrangements. We have actively participated in workshops, meetings and consultations in a bid to make fit for current purpose a regime designed in 2002 for a much younger GB gas market. Rather than repeat the full details of our concerns here, we ask that you refer to previous correspondence, as necessary, to complement this latest consultation response. In essence, we see real merit in modifying the charging arrangements to keep pace with the current gas market and to provide a system which encourages booking of long term capacity (with all associated benefits), which achieves cost-reflectivity, which eradicates cross-subsidies between shippers and which offers reasonable predictability of transportation charges. Changes which facilitate these outcomes will, by extension, also enable the TSO to deliver against the Licence objectives of i) ensuring the efficient and economic operation of the NTS and ii) providing incentives for security of supply.



TOTAL E&P UK

As detailed in previous correspondence from major stakeholders (e.g. Total E&P UK, National Grid NTS, Centrica Energy, Statoil UK), NTS data from the past three formula years shows that market participants are consistently relying upon the lack of competition for short-term capacity, together with National Grid's obligation to release short term capacity at zero cost, as a means by which to avoid capacity charges and legitimately minimise their business costs. Data from 2007/08 through to 2009/10 shows that short term auctions account for ~40% of all entry capacity bookings but provide less than 1% of all entry capacity revenues. Shortfalls in the recovery of revenues by NG NTS through entry charges are collected through the TO Entry Commodity Charge paid by all shippers. Short term entry capacity buyers are therefore having their entry capacity related costs paid by shippers who have previously paid the longer term rate for entry capacity (and who are providing vital market signals). There is no doubt that cross-subsidy is a major feature and flaw of the present system, and these are true cross subsidies as shippers who minimise their entry capacity costs are not creating any cost savings for the rest of the industry. There is also no doubt that any previous correlation between auction participation and value placed upon capacity has been completely destroyed by a system which now disincentives long term bookings. If charging arrangements remain perverse, long term bookings may diminish further to the detriment of the NTS investment planning process and leading to reduced indication of future demand at different locations, inadequate signals to inform investment decisions and increased uncertainty over entry capacity charges over the long term.

GCM19 and associated UNC Modifications were recently developed through the Transmission Charging Methodologies Forum, and in the presence of Ofgem, as a vital first step towards entry charging reform. By vetoing the proposals without suggesting an alternative means by which to address the evident failings of existing arrangements, Ofgem has not only missed an opportunity to stop the escalation of proven malfunctions but has potentially facilitated a worsening of the problem. Project TransmiT provides a timely opportunity for Ofgem to examine NTS entry charge setting arrangements in a holistic manner, to take the lead in addressing and solving the inadequacies of the existing regime, and to direct industry towards a modified arrangement fit for the modern GB gas market. We sincerely hope that Ofgem seizes this opportunity as a matter of priority.

As always, I remain available and pleased to discuss any aspect of this submission.

Yours sincerely

(by email)

Iain McCombie
Commercial Operations Manager