



Grant McEachran
Ofgem
9 Millbank,
London
SW1P 3GE

10 Fenchurch Street
London
EC3M 3BE
Tel: 020 7090 1030
Fax: 020 7090 1001
email:gasforum@gemserv.com

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RIIO-T1: Initial Proposals for National Grid Electricity Transmission and National Grid Gas and System Operator incentive schemes from 2013: initial proposals

A response by the Gas Forum

Introduction

The Gas Forum represents most of the main gas shippers and suppliers to Great Britain. In this response to the Initial Proposals we limit our views to those relevant to National Grid Gas (NGG).

The ultimate aim of the GB gas market must be to provide competitively priced gas supplies to customers. Central to this aim is the achievement of cost reflective, stable and transparent transportation charges. The Gas Forum recognises that the extension of the control period and the more disaggregated approach to targeting specific activities intrinsic to RIIO raises new challenges, which demand new and innovative solutions. At the same time the industry must not lose sight of the duty it has to consumers. Price control mechanisms which undermine the workings of the market, directly or through unintended consequences must be resisted through thorough assessment against this primary objective.

As an association which represents the main shippers and suppliers in the GB gas market, our main concerns are the impact of price controls and associated mechanisms on a) out turn transportation prices and b) the drivers which compel the TSO to behave in a particular manner.¹

¹ In terms of appropriate network investments and market focused activities e.g. constraint management

It is in relation to the first point that the Gas Forum maintains a high degree of concern. Throughout the RIIO process, members have voiced concern over possible impacts on charging stability. We are encouraged by Ofgem's review² of this issue, however, at this stage we are not convinced that the options proposed as part of this review combined with the potential magnitude of the Uncertainty Mechanisms will lead to an environment of stable and predictable prices.

RIIO-T1 Observations and comments

- We welcome the reductions in baseline TOTEX proposed by Ofgem, however, we are concerned for reasons stated above, by the increase in the Uncertainty Mechanism funding provisions. We have a particular concern that the recovery of UM funding costs will, in a number of instances, lead to increases in commodity based charges. As Ofgem is aware, the degree of commoditisation of charges in recent years, due primarily to the under-recovery of capacity related revenue allowances, has had unintended ramifications on shippers. The chief consequence has been uncertainty and volatility in transportation charges.
- We appreciate the recognition by Ofgem that industry is continuing to consider options for the release of incremental capacity. Although significant work has been undertaken, a suite of final proposals is yet to be developed and Ofgem is right not to pre-empt outcomes by making premature adjustments to RIIO allowances. Given that there is an expectation that licence changes will be required to accommodate the capacity solution, the Gas Forum would welcome a commitment from Ofgem to actively participate in the relevant industry workgroups.
- In terms of constraint management we are uncomfortable with the NGG proposal that a single incentive mechanism should apply to both entry and exit capacity constraint management. We believe this structure does not reflect the basis on which the products are sold i.e. independently, and if capped could reduce the risk exposure faced by NGG. In addition, we also have concerns over transparency and the ability for the industry to "audit" activities undertaken by NGG in its position as monopoly provider of capacity services. Incentives are used to encourage certain behaviours by monopoly providers; they should not be seen as a direct substitute for effective regulation of them.

² Mitigating network charging volatility arising from the price control settlement

In terms of the options put forward by Ofgem, we are minded to recommend continuation of the status quo, at least until such time as proper “cause and effect” analysis has been carried out on alternative incentive structures.

- We agree with the recommendations set out in relation to the programme and qualifying criteria for the approval of reopeners. Specifically, we do not believe that NGG should, as a matter of principle, be rewarded with specific and arguably excessive allowances for the provision of market facilitation services, which by their very nature are difficult to forecast with any certainty. That being said, we are not able at this stage to support the application of user-directed fees for services outside of licence activities. We would appreciate further examination of this issue, in particular a review of what sort of services would normally qualify and the level of costs NGG might expect to incur. We are concerned that there will be disagreement over which services NGG might reasonably expect to deliver under licence and the unit costs associated with them.
- We concur with Ofgem’s view that a specific uncertainty mechanism should not be afforded to NGG in relation to steel prices.

SO Incentives observations and comments

- The Gas Forum welcomes demand weighted incentives which seek to improve NGG’s demand forecasting performance. We recommend that greatest emphasis is placed on D-1 forecasts which are more critical for the shipping community and we wonder if the proposed caps and floors might be revisited to reflect this?
- In terms of balancing related incentives we agree with Ofgem that there is no apparent need to modify the current arrangements which have served the industry well since inception.
- We support the replacement of the IAE mechanism with a new and more balanced uncertainty mechanism. This approach will reduce the potential for incentive mechanisms to be reopened following NGG appraisal of downside risk and should, in theory diminish the incidence of reopeners occurring. However, we note that the ability for Shippers to raise an IAE (or equivalent) is proposed to be removed from the arrangements, which although infrequently exercised, has the potential to protect Shippers (and ultimately consumers) from NGG being able to claim excessive rewards. For example, the Gas Forum has previously argued that NGG should not have been able to claim all allowed costs of providing Fleetwood entry capacity, which has ultimately led to a review of the

overall IAE mechanism and how NGG is funded for capacity through revenue drivers. We also note that IAEs tend to be one-way; i.e. NGG claiming for increased rather than reduced allowances and therefore it is important to preserve a route for Shippers to challenge NGG's funding arrangements in exceptional circumstances.

- Finally, we support Ofgem's proposal that NGG should not be afforded ex-ante risk premiums in relation to these incentive mechanisms. The mechanisms themselves will provide adequate risk and reward to NGG in its role as monopoly service provider.

We trust that you find this response to be helpful and if you would like to discuss any of the points we have raised then please get in touch.

Kind regards

A handwritten signature in black ink, appearing to read 'R Fairholme', with a wavy underline.

Richard Fairholme (Chair of Gas Forum Transmission Shipper Group)