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taking care of the essentials

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Gas transmission - new NTS entry points, reserve prices in auctions and unit cost allowances (UCAs)

Dear Nienke,

Thank you for the opportunity to comment on the consultation document "Gas transmission - new NTS entry points, reserve prices in auctions and unit cost allowances (UCAs)". Centrica Storage Ltd would like to bring to your attention the following comments and concerns.

The time between Ofgem's consideration of the responses and the start of the entry capacity auctions is insufficient to enable Users to give sufficient consideration and gain sufficient internal approval to participate in the September auction effectively.

Transco's calculation method uses information gained from external sources to project forward the use of each system entry point and therefore provides pricing levels which are based on estimated system use. This method relies on information from external parties who may have interest in understating future gas supplies at certain entry points.

This proposed mechanism attempts to determine the actual cost of providing additional entry capacity at specific points and then goes on to set the reserve price of the entry capacity auctions at these levels. This causes the auctions at entry points with limited capacity to be driven to prices over and above the actual costs of providing the capacity and will create cross subsidisation to the other entry points. If the clearing price is to be set at the cost level then the auction should be for entry capacity volume at cost price. This would result in volumetric information for Transco and ensure other parties are able to make economic decisions about where to land new gas supplies. The auction can only yield price discovery and valid investment signals where the reserve price is zero at all entry points. Use of a price fixing mechanism on an auction of a constrained commodity will lead to price distortion and will lead to inefficient investment.

Transco's calculation method assumes that increased flow will be matched by equivalent increased demand in the incremental calculation. This artificially increases the demand in the calculation and will also results in prices distorted towards constrained entry points.

The proposed calculation method calculates the delivery of gas to a large number of nodes as the impact on the system. In the case where a facility requires use of the NTS for short haul (possibly to a new facility) or delivers to a point opposite to the peak day flow direction we believe this method will result in unrealistic and non cost reflective pricing. It is unclear if proposed or planned changes in system exit have been considered to the same extent as new gas inputs.

Transco's assumptions do not appear to account for decreasing delivery rates at existing entry points. This omission will lead to exaggerated price signals and possibly unnecessary investment.

Transco's pipeline cost estimates are respectively 11, 25 and 72 percent higher than the cost estimates provided by Ofgem's consultants. If these high costs have been used in the calculations then the results will be distorted towards new pipelines and connections. We urge Ofgem to address the pricing methodology which Transco have used and verify that Transco is providing cost efficient pipeline connections and reinforcement.

CSL provides its storage services at a bi-directional connection point and is especially concerned that this calculation method does not consider the potential income from proposed exit capacity changes in relation to bi-directional connection points such as storage facilities and inter-connectors. New bi-directional connection points will suffer duplicated costs for both entry and exit mechanisms.

The Southern (constrained) LNG facilities proposed prices are the highest and have suffered the greatest increases. These facilities provide additional capacity by enabling the system to transport more gas than it would be capable of on peak days. When the dynamics of the system are considered the LNG facilities provide gas at the system extremities and support transportation of gas from other entry points. Although some benefit is provided from the constrained rebate, the baseline cost of entry capacity at LNG facilities should be minimal if not negative.

Transco's pricing method constrains any cost allocations to positive values; we believe this introduces distortion by inhibiting the models ability to recognise transmission support benefits and the benefits of exit points which are located very close to entry points.

The Easington (and Rough) price has increased by 300 percent; we assume this is due to the proposed landing of the Langeled pipeline. Existing users of this point will therefore be subject to increased costs and be caused to subsidise the delivery of the new Orman Lange gas. Long term entry capacity is generally not booked at Storage entry points due to the uncertainty of securing capacity through auctions.

The historical and existing entry capacity prices (and constraints) at St Fergus have incentivised additional investments to build pipelines to deliver gas further south to Teesside and Easington. If the entry capacity prices are changed in the manner proposed then such additional offshore pipeline investments will be unable to benefit from the existing capacity prices. This inefficiency will ultimately be passed onto the consumer.

In conclusion:

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We believe that Transco's bilateral and annual consultations provide much more accurate, practicable and longer term information than any capacity auctions performed to date. Ofgem's opening statement "The Long-term auctions have provided important new information on the likely pattern of gas flows across the NTS" is true when considered in isolation, but we have not seen any evidence to date that the auctions have caused Transco to invest in a more efficient manner nor added any useable information over and above the bilateral consultation processes.

The existing capacity auctions and pricing methodologies could be changed to be more cost reflective when Transco's system is considered in isolation. The methodology proposed will not necessarily lead to the most cost efficient solution for the industry and consumers unless the costs and investments of the whole industry are considered.

To date the entry capacity auction process has only identified capacity constraints at St Fergus and has caused gas to be landed further south than might have been most efficient in the long term. We believe that changing the pricing using the method and timescale described will add unnecessary additional costs to the Industry and hence consumers.

Changing the UCAGs in this manner and timescale may provide benefits by addressing some discrimination issues but we urge Ofgem to balance this against the efficiency, discrimination and cross subsidies that could be created.

Regards

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