

ExxonMobil International Limited
St. Catherine's House
2 Kingsway
PO Box 394
London WC2B 6WG
020 7412 2916 Telephone
020 7412 2650 Facsimile
ian.r.trickle@exxonmobil.com

Ian Trickle
Europe Regulatory Advisor

ExxonMobil
*Gas & Power
Marketing*

30 June 2005

Nienke Hendriks
Senior Manager, Gas Transmission
Office of Gas and Electricity Markets
9 Millbank
London SW1P 3GE

Gas Transmission - New Entry
Points, Reserve Prices In
Auctions and UCA's

Dear Nienke,

Thank you for the opportunity to respond to the consultation. ExxonMobil International Limited is responding on behalf of its UK gas shipping entity, ExxonMobil Gas Marketing Europe Ltd.

The consultation seeks views on whether:

1. The next QSEC auction should be delayed in order to allow a complete rework of all UCA's
- or
2. New entry point UCA's should be set and capped on the basis of the UCA at the nearest existing entry point

In the case of the first option Ofgem seeks views on many "technical" or "modeling" questions (Chapter 3). Commenting meaningfully on such matters as increment size or the number of years for averaging LRIC results requires in the first place expertise that is unlikely to be readily available to us and probably many other shippers. In any event we do not believe it necessary for the immediate decision where the focus should be more on policy, principles and potential impacts – the area we focus on for our response. Given this we have not been overly precise in our use of acronyms and where we use the terms UCAG, UCA or auction reserve price these are used synonymously one with the other.

The questions seem to us to be

Registered in England
Number: 3834848
Registered Office:
ExxonMobil House, Ermyn Way
Leatherhead, Surrey KT22 8UX

An **ExxonMobil** Subsidiary

Is there anything really broken with entry capacity? Is it so far broken that it needs a major refit ? Or is it simply that there are some pipeline projects that need to be pragmatically priced so that the projects involved can make final investment decisions ?

It is our view that Option 2 above is the most appropriate, given the choices available, as there is nothing so fundamentally broken that a major fix is required in the next month or so.

Focussing on policy principles and impacts we hope to demonstrate why Option 2 is an appropriate one ; we particularly hope to illustrate why pricing stability or predictability in long term arrangements is important and why the Option 1 approach could be seen as destabilizing by many market participants, and not in the overall interests of GB consumers.

Overall Perspective - Policy

In its Summary Ofgem notes that *“this consultation covers not only issues relating to the new UCAG’s but also the possible resetting of all existing UCAG’s before the next round of long term auctions, presently scheduled for September 2005”*. Later it is mentioned that *“In particular, changes in the pattern of flows across the gas network imply very significant changes in long-run incremental costs....”*

In the substance of the document it emerges that this is the primary reason for a re-evaluation of LRIC’s that in the instances of several entry points leads to a UCAG of zero. This is an entirely forward looking assumption which clearly ignores the investment made over the last thirty years or so. Whilst Ofgem may be giving locational signals to shippers that it is better to bring new gas into a terminal that has spare capacity, it seems to us discriminatory that previous investment to provide capacity at a terminal is ignored in setting that terminal’s baseline entry charge. In effect it is countenancing a cross subsidy as Transco still require the same income, so if several entry point terminals have zero entry charge, the other entry locations must therefore be paying more.

A cross subsidy situation is already forecast to arise next year where the TO commodity charge is predicted at over £40M and under current rules will be recovered uniformly across all entry flows irrespective of how much revenue has been recovered at those locations.

To avoid fixing something that is not fundamentally broken there are two other alternatives that could be considered and which would allow current UCA’s and a TO commodity charge concept to remain

- (a) Apply the TO commodity charge on a locational basis according to the level of under recovery at that location.
- (b) Change Transco’s licence obligation in relation to clearing auctions so that it can levy a minimum charge for entry capacity at daily auctions to maintain the level of investment recovery at that location

In Policy section 7 Ofgem lists five principles which it argues *“would be consistent with its statutory objective of protecting consumers and promoting competition”* adding that *“they*

would also embody key aspects of good regulatory practice including transparency and consultation” and “would be broadly consistent with the approach used to set electricity transmission charges”. The list of principles Ofgem refers to is listed below (*marked in italics*). We provide what we believe to be a valid interpretation of these principles both individually and collectively (**marked in bold**).

1. *UCAG’s should be set in a timely way so as not to frustrate the legitimate expectations of project developers*

Interpretation : a pragmatic approach to pricing decisions may be adopted to protect to avoid risk of delaying new projects.

2. *UCAG’s should reflect long term costs, be non discriminatory and facilitate competition between shippers and suppliers*

Interpretation : Ofgem will procure that Transco sees strong incentives to provide accurate and consistent price or cost estimates that could not on any occasion be construed as misleading, incomplete or lacking in transparency; this would recognize that the consumers’ interest here is to ensure that GB secures its reputation with developers of infrastructure and long term providers of gas resources

3. *UCAG’s should not create perverse incentives including for the bypass of Transco’s network*

Interpretation : costs to the consumer of providing access for current and future new gas supplies will be in all respects efficiently incurred ; charges will be levied so that the justified cost of new infrastructure will be recovered from those utilising the investment over a regulated period of time [45 years] at an applicable regulated rate of return.

4. *UCAG’s should be set by a transparent process and informed by consultation and expert advice.* and 5. *For the next price control period Transco should be responsible for setting UCAG’s (consistent with the approach used by other network operators where the licensee sets prices and Ofgem approves any changes to the underlying methodology)*

Interpretation : Ofgem will provide such oversight to Transco’s pricing methodology (using expert assistance where needed) to ensure as far as reasonably possible consistency, stability and predictability in pricing.

Ofgem’s letter entitled “January 2003 Long-term entry capacity allocations” dated 5 December 2002, acknowledged that “*both Ofgem and Transco recognize the desire for stability in the [auction] price schedules*” and that “*the impact of any changes in incremental costs on the price schedules will be minimized as the price schedule costs are linked to the UCA’s which have been set for the duration of the price control period*”.

Impact Of Significant UCA Changes - St Fergus Example

Option 2 involves as Ofgem points out a complete recalculation of UCA values based on an update of projected system entry flows. Under such an arrangement, some UCA's increase and others decrease. At St Fergus, the UCA value would drop to zero. In our view this would be a truly discriminatory achievement given the significant levels of investment that have been undertaken at that location over the last thirty years.

Such a significant change directly raises questions about who will be paying for that investment in the future. The regulatory arguments would centre around the need for a strong locational price signal to bring new gas resources to St Fergus ; in practice however there has to be a reality check here as to whether the signal would make any practical difference to investment decisions and further, any parties relying on such a price change to justify a new investment would need to then consider whether they could rely on the regulatory regime remaining unchanged after an investment was made.

It is also worth testing the value of a locational entry capacity signal to a potential new entrant when compared to other signals in the market such as forward commodity prices and supply demand outlooks. In the grand scheme of those things that influence a new entrant or a new development we would place the relative prices of entry capacity towards the lower end.

What is becoming more important is that there is

1. A framework to secure long term pipeline investment to provide access to market.
2. A clear basis on which an entry capacity investment decision can be made
3. Confidence that the economic basis for future entry capacity requirements will remain predictable within reason.

Once again , the regulatory temptation to claim that changes to provide locational price signals are in "consumers best interests" must be tested against the likely impact that they will have at that location and compared with the greater risks for GB consumers that may arise if the regulator sends different and unhelpful signals to the broader market on which GB will depend in the future. Such unhelpful messages that could be implied in an Option 1 choice include :

1. **To shippers who have already booked capacity** – *“to attract new entrants we have to charge less than you have already paid over the same timeframe ; it is important that we avoid stranded capacity even if this undermines the value of the investment you have already made”* .
2. **To foreign producers investing in major new infrastructure and planning to bring new gas supplies to the UK** – *“we’ll ask you to make major commitments on pipeline infrastructure, but you must understand that our unfettered discretion allows us to change the basis on which you made your initial project assessment and we may ask you to pay much more than your fair share as time goes by”*

3. **To the worldwide gas market** – *“we want you to come and supply gas to our market and comply with the regulatory regime but this regime may not be predictable nor stable”*.

Conclusion

We are not surprised that Ofgem has decided to take a close look at the long term capacity regime given the pressure for pipeline pricing decisions from new storage and infrastructure projects.

We do not believe that the entry capacity regime is broken to the extent of requiring the level of change represented by option 1 but we see many destabilising consequences from employing such an approach. The significance of the issues under consideration are no less than they were at the time of Mod 0500 development and should be treated with the same caution as at that time. A more appropriate timetable for consultation on UCA fundamentals (option 1) would be one that is tied to the implementation deadline established for the next price control, rather than the next QSEC auction. In that event we would expect to be better able to provide meaningful comment on some of the technical aspects on which Ofgem has sought views.

Based on the analysis above we favour a resolution of the pricing issues for the various new entry points using Option 2 i.e. use the nearest existing entry point UCA and cap at that level so as to provide a stable price signal for the new projects. .

We hope that our views will be of value to Ofgem in determining the path forward.

Yours sincerely,

A handwritten signature in blue ink, appearing to read 'I. Trickle', written over a light blue rectangular background.

Ian Trickle