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Consultation on Gas Transmission, new NTS entry points, reserve prices in auctions and unit cost allowances (UCAs)

Total E&P UK PLC welcomes Ofgem's invitation to comment on the above mentioned consultation document.

As part of the shipping community Total E&P UK PLC supported the introduction of the first Long Term System Entry Capacity Auction (LTSECA) in January 2003. The LTSEC auctions were designed to provide the industry with more certainty and improve the market signals Transco received, thus helping efficient investment decisions. It also provided stability in terms of pricing, as the baseline capacity prices are linked to the UCA's which had been set for the duration of the price control period (2002-2007), point which was confirmed in Ofgem's letter dated 5 December 2002.¹

Having actively participated in the development and introduction of the LTSECA, Total E&P UK PLC also participated in the LTSECA, buying significant quantities of entry capacity at several entry points.

In the recent document Ofgem outlines the problems in setting UCAG's for new sites as changes in the pattern of flows across the gas network result in changes in the long-run incremental costs, and so result in new UCAG's which are very different to those of existing nearby entry points. The document presents two options:

1. Reassessing all UCAG's ahead of the price control review using the new method. This would result in cost-reflective UCA's at every entry point.
2. Retain existing UCAG's and use them to cap UCAG's at new entry points.

Views on Option 1

Having bought a high proportion of our requirements for long-term capacity we are now faced with a possible review of the UCAG's at St. Fergus, which potentially would bring the price of entry capacity at that system entry point to zero. In addition, from October 2004, a TO commodity charge has been levied on all entry flows, to address the forecast TO revenue under-recovery, and only recently Transco has announced that due to an under-recovery from entry auctions, this charge would increase again compared to that introduced in October 2004. We are surprised to see Transco consistently reporting an under recovery from entry auctions when compared

¹ January 2003 Long-term entry capacity allocations – letter from Kyran Hanks, Ofgem dated 5 December 2002

to the target of 50% of Transco's NTS TO allowed revenue, and at the same time Ofgem proposing changes which would effectively bring down to zero the reserve price at a highly used network entry point.

We are aware that Ofgem is proposing an increase in the UCA's at other network entry points where future gas flows are expected, but we have no certainty that the proposed increase will be sufficient to allow Transco to recover the targeted 50% of NTS TO revenue from the entry capacity auctions. If there is in the future a revision of the UCAG's the increases should be high enough so that there is a reasonable expectation of no under-recovery and hence a zero NTS TO commodity charge.

We believe in the benefits of regulatory certainty, and we do not consider that bringing forward the frequent reassessment of all UCAG's is in line with this. Also bringing forward the review of the UCAG's would contradict views recently expressed by Ofgem in connection with the Enduring Off-take arrangements. In your letter of the 24th June 2005², you mention you have "identified a number of interactions between the NTS off-take arrangements and the NTS entry capacity regime that need to be considered...primarily in the setting of baseline capacity levels...and the setting of UCA's"

As these interactions have not yet been analysed we believe it would be premature to propose significant changes to the UCAG's ahead of the Transco NTS price control review, which will give Ofgem the opportunity to address the issue globally and is due to be completed by April 2007.

However we also recognise that purchasers of capacity should be required to pay a reasonable cost reflective price and that significant changes in flows could affect the cost drivers. A variation of Option 1 could therefore be to only adjust those entry points at which analysis suggest higher UCAG's are required – i.e no UCAG downward revisions should be allowed. This would give support to one of the principles of the LTEC that short term prices should not be widely divergent from long term prices as otherwise the incentive to book long term is weakened.

Views on Option 2

For the views expressed above, we believe that it is preferable for the time being not to revise UCAG's at all entry points. In that respect Option 2 satisfies the industry's need for stability and certainty within a price control period. We agree with your views that this would allow for more time for further consultation and further refinement on the cost estimates underlying the UCAG's for existing terminals.

We believe that implementing Option 1 as it is proposed could create uncertainty which could deter shippers to committing long-term in entry-capacity auctions. This would damage market signals received by Transco and so damage the credibility of the Long Term System Entry Capacity Auctions.

² Enduring Offtake Arrangements – letter from Alistair Buchanan, Ofgem, dated 24 June 2005

Should you wish to discuss further any of the points raised in our response, please do not hesitate to contact me.

Yours Sincerely
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