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Dear Robert,

Transmission Price Control Review – Second Consultation

Thank you for the opportunity to comment on the above consultation. Statoil (UK) Ltd (STUK) is responsible for the marketing supplies of its parent company's Norwegian equity gas and the Norwegian State's equity gas in the UK market. As we both import gas into the UK and maintain a supply portfolio we are directly affected by changes to the National Grid Gas price control. It should be highlighted that as we only utilise the gas network of National Grid, STUK have restricted our comments to the relevant parts of the Ofgem consultation.

Entry and Offtake Capacity baselines and Revenue Drivers

STUK are in support of retaining the current arrangements for the setting of the capacity baselines at both Entry and Exit. Using a theoretical maximum approach to setting baselines as adopted in the last price control review, especially at Entry will prevent the undermining decisions made by shippers in previous long term entry capacity auctions. A theoretical maximum approach to setting the baselines is the simplest and more objective method of those mentioned in the TCPR consultation, also as it is an existing process will it have little implementation impact on the industry and as it is likely to result in a comparatively high baseline will give shippers a high degree of certainty.

Using the Practical Maximum, or an assessment based on the network 1 in 20 demand scenarios does not take into account the dynamics of the system. A practical maximum and 1 in 20 scenario creates risk that the baselines would be set either too low or too high as the assumptions will be more subjective. The reliance on assumptions is also a risk as the robustness of the entire process is dependant on the scenarios used. Using a 1 in 20 scenario will not effectively take into account the change of use of the NTS that we are currently experiencing. Since the 2002 price control we have seen an increase in the UK's reliance on imports and storage to meet any shortfall in supply, something which we know will increase. Utilisation of the NTS will change further as dependence on imports increases.

Models such as 1 in 20 cannot be used to model baseline entry capacity levels. Interconnection with Europe and LNG regasification capacity mean that the UK is linked with a global energy market and capacity levels may differ significantly from actual supply levels from year to year as the UK switches between under and over supply situations and new infrastructure is brought into use.

We have already seen that the previous use of a 1 in 20 baseline can cause over recovery during the first short term auctions in 2000. A 1 in 20 baseline level was set for St Fergus reducing capacity levels during the summer leading to an over recovery through the entry auctions. While the auction methodology in the Long Term process is different similar difficulties could arise with this approach. Even if the 1 in 20 were used as a flat rate throughout the year it may still unnecessarily reduce the level of capacity available.

As a result STUK favour option E1 in the consultation as this maintains much of the process created in the 2002 price control. We consequently believe that incremental changes are better when establishing a long term regime than more significant changes at each price control. It is important to highlight that we have only had 5 years of the current regime and as yet not allowed sufficient time for the full process to complete (e.g. bidding, allocation, investment and use).

A nodal approach for Entry allows Ofgem to determine separate revenue drivers at each entry point, which enables clear details of the required baseline capacity in return for revenue allowances. STUK recognises that the model was not designed to account for new entry terminals and additional adjustments may need to be considered here to ensure National Grid can recover the appropriate levels of revenue. The lack of investment signals at existing terminals does not, in itself, identify a need for change.

STUK believe that the current transitional Offtake revenue drivers should also remain. Making these arrangements permanent would add further stability to a regime that has undergone significant change recently and offer the degree of certainty needed by existing industry participants to ensure their efficient operation and would involve minimal implementation costs.

STUK are of the belief that the Entry and Offtake provisions for the UK NTS should be kept as simple and transparent as possible to allow for timely and focused investment into the system. Keeping the regime consistent with the current arrangements will provide investors the time and the information needed to consider their investment options. Revenue drivers should be rolling to ensure appropriate investment signals are given. A consistent baseline will also help to encourage investment as a clear indication of the baseline levels will be available for the entire price control period, and help Ofgem to achieve their objectives for this consultation.

Offtake Reform

STUK do not agree that further Offtake reform is required. STUK have great concern with the proposal for a single Offtake product for both Distribution Networks and Direct Connect customers.

Although both connected to the NTS, DCs and DNs have very different requirements. DCs are end consumers and should be afforded the same rights as other similar sized

consumers connected to a DN. They require the same flexibility to change supplier as other major end users. Having different procedures for End Users could lead to some users having a commercial advantage purely by having located on a DN.

Long term user commitment models could restrict a DC from changing shipper as their capacity arrangements would be booked for an extended period with their current shipper and require additional contractual complications to ensure that capacity can follow the end user. The change of ownership of capacity with the change of supplier, would increase the administration costs to the market, delay transfer times and increase the complexity of supply contracts.

The current arrangements for DN capacity bookings (three years ahead) are appropriate for indicating the need for incremental capacity. The ARCA arrangements allow the additional revenue required to be sourced while gaining a level of commitment that the capacity will be used preventing sterilised capacity on the network. The ARCA arrangements are an agreement between NTS and the connectee, the DC will be involved in these discussions and will be expected to contribute to the costs, the ARCA impacts them as a financial commitment is needed.

The longterm commitment made by users in the building of plant should not be undervalued. Significant investment is made by a user and should be considered in the capacity planning process, it is unlikely that after building a large investment that a site would exit the UK market in a short timescale. It is important that any solution continues to encourage consumers to choose gas a fuel and the United Kingdom as an appropriate location for their businesses. Increased complexity and costs can only act as a disincentive.

It should also be highlighted, that any changes to the Offtake regime will not only affect Distribution Networks and Direct Connects but also Interconnectors and Storage Operators. As all of these types of user work in very different ways, a single product will not be the most efficient set of arrangements. Care needs to be taken that any change in the regime does not effect how these different types of user operate and that security of supply is assured. In creating the DN's the network sale established a very different user of the NTS that those existing before. It is only right therefore that different contractual arrangements exist for them.

It is difficult to fully assess the entire benefits and impacts of longterm user commitment models in detail, as the models have yet to be finalised and no cost benefit analysis has been completed. There is also no evidence that the DNs believe they would benefit from such arrangements and through previous price controls it is clear that the shipper community is yet to see how a reform of the offtake arrangements will be of benefit.

STUK are of the belief that the Status Quo offers what is needed at Offtake for both the DNs and DCs. It is difficult to see how Long Term User Commitment models will meet the defined objectives as there is little known of the full impact of the reform. The proposed changes would not protect the interests of consumers or allocate risk appropriately. Asking DCs to commit to long term capacity could have a detrimental effect to competition and therefore risk.

Buy Backs

STUK recognise that there are different situations where buy backs may apply. In particular new investment is very different from operational management of existing infrastructure. A further area for consideration should be the difference between new infrastructure (LNG import terminal or storage project) in comparison to incremental investment at an existing point. Where new investment has been made it may be more difficult to ensure compensation is paid as the user will not be able to flow any gas and National Grid could avoid buy back costs. It may therefore be better to apply a different approach in these circumstances especially as the costs associated with the non delivery of a connection for new infrastructure could be significant.

The Role of Charging Within the Framework

STUK believe that the ability to frequently update the reserve prices following the separation of the charging methodology from the price control could lead to some gaming around commitment to entry capacity booking. Significant shifts in pricing may lead to shippers trying to second guess pricing changes and dilute the investment signal. It should not be assumed that establishing a formal methodology for the setting and amending of reserve prices will automatically increase transparency; this can only be assured if the formulas used are openly developed and the information used is of a high quality.

Revenue under recovery through Entry Auctions

The current regime allows within day capacity to be purchased at zero price in the within day auctions with any short fall in revenues recovered through the TO commodity charge. This smearing of costs does not appropriately target the users of those entry points who are causing costs to be incurred, making all users of entry capacity (and ultimately all consumers) bear the cost. The existence of reserve prices would to some extent limit the level of under recovery and target the costs of providing that capacity at those who utilise it. Furthermore it may also encourage greater participation in the long term auctions as there is less incentive to buy capacity within day.

In general STUK favour an approach to the TCPR which encourages stability and some certainty for both entry and exit capacity arrangements. Continual and significant changes will undermine the desired outcomes of long term auctions which is to enable Shipper and National Grid to interact and signal the need for investment. At exit greater consideration needs to be given to end consumers who will be significantly affected by increased contractual complexity and costs if further changes to the regime are made.

STUK trust that our comments will be given due consideration and should you wish to discuss any aspect of this response further please contact me on the above number.

Yours sincerely

Robert Cross
Regulatory Affairs Manager