

## TOTAL GAS & POWER LIMITED

Robert Hull  
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9 Millbank  
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Dear Robert,

### **Transmission Price Control Review 2007 – 2012: Third Consultation**

Total Gas & Power Ltd is responding to this consultation on behalf of itself and also on behalf of Total E&P UK plc. TOTAL welcomes the opportunity to comment on the price control review. We have restricted our comments at this stage to the proposed reforms to the Gas Entry regime as the Enduring Offtake Working Group is focussing on most areas related to the Gas Off-take Incentives. We would however like to comment that we are supportive of the progress that now appears to be taking place re the offtake arrangement reforms and the development of proposals for the transitional and enduring periods.

We are also appreciative of the approach that is being taken to work with the industry and to encourage the open sharing of views through both the consultation process and through workshops/meetings. Whilst we recognise that Ofgem is working to a tight timetable and that there is a lot of work to be done in order to publish the Initial Proposals in June 2006, we believe there will be value in a further opportunity to meet either directly or through say the Gas Forum Price Control workgroup before June.

### **Chapter 4**

#### **A - Gas Entry Incentives**

**Question 4.1 Do you agree with our plans to change the nature of NGG NTS's licence obligations to release entry capacity? What particular measures are needed to ensure that the regime is transparent, and ensure against capacity being held back unnecessarily?**

#### **Overview**

We have serious reservations about the plans to change the way in which entry capacity will be released. We understand Ofgem's intent to ensure that the network is run efficiently and to encourage full use of "spare" capacity in the network prior to authorising requests from NGG NTS to provide incremental capacity. However we also understand that the main drivers for any such incremental capacity will be new entry points that are likely to arise over the next few years. If this is the case then it



is our initial view that much of what Ofgem want to achieve can be done through a sensible re-allocation of the existing baselines where it is clear that these are in excess of the anticipated entry capacity demand rather than a radical review of the whole entry capacity fundamentals.

TOTAL would like to see a lot more evidence of the realistic potential savings that it is believed could be achieved by moving to the proposed mechanism – i.e. of the “incremental” capacity that will need to be built to support new entry points over the next few years, how much of this could in practice be moved from existing entry points versus genuine new incremental capacity. For example it is clear that Milford Haven would have been all incremental under any proposal. Further an assessment also needs to be carried out as to how much of this could have been achieved by a realistic re-assessment of the existing baselines based on the outcome of the current long term auctions and the information obtained through the TBE, planning and associated processes.

Further Ofgem must be aware of the message that is given to the industry when fundamental change is proposed to a significant area of the regime even when the current entry capacity baseline approach has only been in place for a relatively short time. We believe that a change to the current regime would increase the uncertainty faced by new developments making it more difficult to assess costs. This combined with the lack of certainty as to the amount of capacity that could be made available at any of the existing entry points in future auctions (following your proposed model) could represent a greater risk for the development of new projects. These changes could also affect gas imports which will be arriving from increasingly distant sources and which may be diverted easily to other markets.

## **Background**

When the current entry capacity regime was developed in 2000/2001, a number of options were evaluated. One of these (modification proposal 508) suggested an auction process that through its iterative nature and the ability to change bids within an auction and between different terminals, provided a capability to explore network efficiency. However opponents to the proposal argued that it would be too complex and that the current modelling capabilities were insufficient to automate such a process. Ofgem supported these views when it agreed to implement modification 500. We therefore wonder what has subsequently changed such that it is now believed that the new proposal could be managed using the NGG NTS network model supported by a “transparent” capacity release methodology.

## **Capacity held back for short term auctions**

We believe the current capacity regime since 2002, whilst not perfect, has worked reasonably well. Significant quantities of capacity have been bought long term using the baseline approach. Clearly when deciding on whether or not to make such bookings, the purchasers were aware of the rules including the reservation of 20% of the baseline for release in the shorter term auctions. Whilst this rule was heavily debated at the time, Ofgem insisted on it being in place, primarily to ensure that some capacity would be available for new entrants. It is our understanding that



should the proposals be implemented this concept (the 20%) would disappear as there would no longer be a baseline. An inherent feature of the offshore industry is that full production rates for fields can not always be calculated until almost real time, particularly for marginal fields that may well rely on other field developments. Similarly shippers buying at the beach may find themselves with potential short term swing that they could not anticipate when booking in the long term auctions. Thus there needs to be some flexibility in the onshore infrastructure if all potential gas sources are to be maximised.

We therefore have two questions in connection with this:

- Firstly, how would new entrants, which could include both new shippers and existing shippers having new gas (say from existing fields that can be successfully enhanced), obtain capacity if based on the long term bookings “spare” capacity has been transferred elsewhere?
- Secondly, can the 20% be transferred when it was clear obligation at the time the bookings were made that it would be later released?

## Risks

TOTAL has serious reservations about whether this proposal could be achieved such that the industry could be confident that capacity was being properly optimised. Further we have concerns that a serious risk of such optimisation could be that capacity once again became constrained from time to time resulting in either short term rises in capacity prices or gas being prevented from being delivered because of an unavailability of capacity. One of the main drivers for the long term process was the problem that the industry suffered in the late 90's/2000/2001 when the short term auction process, where the capacity offered was determined by NGG NTS (then Transco), produced extremely high capacity prices and huge revenue over recoveries.

Any new proposal has to be extremely confident that it will not lead to the industry reverting to this situation. In the second consultation Ofgem recognised that one of the disadvantages of Option E4 (no ex ante baseline) was that it could involve significant discretion by NGG NTS to determine the total amount of available capacity and how it should be allocated between different points on the network. Ofgem appear to rely on the obligation on NGG NTS to develop a transparent capacity release methodology and to publish a network model to allow shippers and others to understand how the methodology is being applied, as the means of mitigating this risk. However from our past understanding we find it very difficult to believe that this degree of transparency could be provided such that there was total confidence in the capacity figures that would be published by NGG NTS under such an approach.

It would therefore be likely that the industry would expect Ofgem to take a more active part in assessing the outputs from the methodology and the model. This would reduce one of the perceived advantages of the option in terms of reducing the ex ante involvement of Ofgem.

## Summary

In summary we are not supportive of the proposals as outlined in the consultation.



We recognise that the proposal could have some advantages but that these have to be weighed against the risks of moving from an established regime which has been used to generate significant financial commitment from the industry together with the risks of re-introducing the potential for capacity constraints at a time when the system needs to have the flexibility to both encourage new sources of gas as well as maximising the gas from traditional sources. We would therefore recommend that we stay with the current approach along the lines of option E1 referenced in the second consultation.

Recognising that the baselines were originally set for the last price control based on available information at that time, we would not have any fundamental objection to the baselines being reviewed as part of this price control. Such a review would necessarily take into account any current information including capacity already purchased in long term auctions and allowing for the 20% held back.

There may also be some justification for looking further at option E2 particularly if new entry points are likely to be physically located close to existing entry points. Finally bearing in mind recent industry discussions, should any future capacity release methodology be required it should be included as part of the UNC rather than the licence as its major impact is on the commercial arrangements between NGG NTS and shippers.

## **B - Revenue Drivers**

### **Question 4.2 Do you agree with our plans to refine how the revenue drivers in cases where NGG NTS provides extra entry capacity, as requested by network users?**

TOTAL agree that the current price control calculations to adjust revenue allowances upwards if NGG NTS releases additional capacity, are complex. Whilst complexity alone does not justify change, we consider it has been detrimental to the industry's, and perhaps Ofgem's, ability to fully comprehend the implications of the interactions and thus effectively monitor the arrangements.

We would like to understand better how the trigger level concept will work and how the levels will be calculated. We would also like to know how the trigger levels may interact with any incentives placed on NGG NTS to maximise capacity across the network. It is imperative that if incremental capacity is required then there should be nothing to financially discourage NGG NTS from carrying out such investment. However, we would state our support for the return for providing additional capacity to be fixed at the standard cost of capital. TOTAL have never understood why a monopoly provider needs to be rewarded at a rate above the standard cost of capital where it is guaranteed that it will be allowed to take the investment into its asset base and thus have no future stranded asset risk.

Clearly the deemed cost needs to relate closely to the actual cost otherwise it may disincentivise NGG NTS from providing required incremental capacity or may encourage NGG NTS to make inefficient reallocations of capacity across the network. As such, it may be necessary to adjust the revenue allowances even within a price control if there are exceptional changes.



We support the proposal to provide stability by retaining entry point specific revenue drivers fixed for the period of the price control.

### **C - Charges for entry capacity**

We note that this issue is being discussed at the Gas Transmission Charging Methodology Forum (GTCMF). However we would stress that frequent changes to transportation charges should be avoided, if at all possible. Certainly the potential for changes within year causes uncertainty which may result in additional risk premiums being built into prices. We are not clear why there should be a need for frequent revision in practice as, over the 5 year price control period, there are unlikely to be major changes to network flow patterns.

Further the industry needs to have a high degree of confidence in the transparency of the capacity charging methodology and to go towards providing this it is recommended that the methodology be incorporated into the UNC and managed through the existing associated governance processes. .

It must also fully address the issues associated with the management of any under or over recoveries generated via the charging mechanism. Whilst over recoveries have not been an issue in the current price control, the previous entry capacity mechanisms gave rise to significant over recovery and a satisfactory solution to how these should be managed was never developed.

### **D - Buyback Incentive**

**Question 4.3: Do you agree that changes are needed to the arrangements for buying back capacity rights, in particular to ensure a different sharing of risk between shippers, NGG NTS and consumers in respect of capacity which is dependent on large investment projects?**

We are supportive of the principle that any costs associated with a failure to provide capacity that has been sold as part of a large investment project should be resolved between NGG NTS and the shippers who have bought the capacity. Clearly however there are a number of issues that need to be addressed in moving towards such an approach.

Ofgem's comments seem to imply that they believe the current bargaining position may be unduly favourable to shippers. Any reform must be careful that the bargaining power does not switch completely to NGG NTS who at the outset are in a very strong position, knowing full well that a shipper is very unlikely to be able to walk away and make alternative arrangements for the provision of any new pipeline and/or reinforcement. The timing of the agreement of the buy back terms will also be important as they may influence the long term capacity bids that will be needed to confirm the go ahead or otherwise of the project.

Whilst we also agree that NGG NTS may need to be allowed some protection for events that are outside their control, this has to be very closely managed in order to ensure that NGG NTS are still fully incentivised to do everything that could reasonably be expected of them to minimise all the risks associated with this type of



project.

We support the proposal that associated costs and revenue should be treated as excluded income for the purposes of the price control. We have in the past argued that this should be applied to any incremental capacity such that where NGG NTS had sold incremental capacity but had been unable to meet the full level of nominations, then they should be required to buy back the incremental first with any associated costs excluded from the normal buyback incentive mechanism. We still believe there is merit in this although it will clearly need to be looked at alongside the overall entry capacity sale mechanism, should this be amended.

Is it Ofgem's intention that under the proposed new entry capacity arrangements NGG NTS will be able to buy back capacity at one entry point in order to sell additional capacity at another entry point? If this is allowed then any costs and revenues associated with this should not form part of the standard buyback incentive but instead treated in the same way as incremental. Other than this, we are not supportive of any move to place restrictions on the level of buyback compensation for existing capacity along the lines of those areas being considered for large investment projects.

Please do not hesitate to contact me in response to any of the above comments.

Yours sincerely

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