VIRIDIAN

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28th April 2006

Robert Hull
Director, Transmission
Office of Gas and Electricity Markets (OFGEM)
9 Millbank
London
SW1P 3GE.

<u>Ref:</u> Response to "Transmission Price Control Review 2007 – 2012: Third Consultation" dated 30th March 2006.

Dear Mr. Hull,

Viridian, as an active shipper in the Irish gas system, is directly affected by any change to the existing NTS rules particularly to the extent that they affect treatment of the Moffat Exit Point. We thus make comments on the referenced document and ask that they be given careful consideration.

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General Comments

(A) This consultation paper, unlike previous papers on the same topic, contains no details in relation to if there will be a Flexibility Capacity Product, and if so if it will be bundled or unbundled product from the Capacity Product discussed in the paper. Without such important detail it is impossible for any party to make any real and thorough assessment of the potential true impact of anything being suggested in this consultation paper or as part of the overall Exit Reform in general. As such Viridian strongly believes this paper should not have been consulted upon without such missing details concerning flexibility.

(B) Due to General Comment (A) above Viridian reserves the right to amend, change or refine any of the comments made by it in this response to the referenced consultation paper.

(C) As per Viridians comments on the 2nd Consultation Paper in January (ref. Specific Comment on section 7.7) Viridian is still does not see the rational for moving away from the Status Quo Option Ex1 and a bundled flat and flex product, and as such still cannot support any such proposed move. Viridian believes the Status Quo has worked well for many years but if in spite of this, Ofgem still deem some greater comfort is required concerning investment signals to NGG then as suggested previously (by many parties including Viridian) a variation of the ARCA could be considered. Alternatively it is suggested that a variation of the latest ideas from the EOWG discussions involving rolling rights and longer term commitments could be considered <u>if and only if;</u>

a. the commitment timings are realistic and reasonable – the timing of 7 years commitment as an undertaking to pay charges (which are unknown in advance) is considered unreasonably excessive for many parties (due to financial liability limits), will act as a barrier to entry for new competitors, and will force gas Suppliers to contract with End Users for longer term contracts thus reducing the ability of the customer to move and thereby reducing customer movements

b. there is some degree of flexibility in the application of the product i.e. the commitments in advance can be for various amounts for different years and do not have to be exactly the same booking for each of the years
c. flexibility is not sold/booked as a separate product to capacity or treated in any way differently to the manner in which it is treated today i.e. inextricably linked with the capacity booking.

Viridian still strongly argues that the idea of having a separate flexibility product is unnecessary, difficult to understand (especially how one can ever assume that in some way a piece of pipe, which has <u>both</u> capacity and flexibility inherent in it, can in some way be deemed to be required or installed (or used) for solely "capacity" or solely "flexibility" reasons), costly to implement and operate, and excessively complex to administer or operate for both NGG and/or Shippers.

If Ofgem are concerned about DCs (or any other party) excessively over utilizing NTS system flexibility they could if they wished separately impose an upper limit on usage variations on such parties (or separate limits on separate categories of users) without having to go down the road of devising a completely new regime incorporating separate capacity and flexibility overrun penalties.

<u>(D)</u> Moffat is not a "standard" NTS Exit Point. It is different from all other NTS Exit Points. It is the NTS Exit Point from the NTS which only delivers gas to, and does not take gas from, three jurisdictions including a separate member of the EU. It is also the only Exit Point around which there are inter governmental treaties – such treaties would not have been needed if Moffat was a "standard" Exit Point. Due to the unique nature of Moffat it is argued Ofgem should give it exceptional status in order to address vast array of issues which are inherent in such a complex, multi-user, multi-jurisdictions, multi-regime point. In truth Moffat is an inter-market connection point between several markets within the EU and should be uniquely treated due to this.

<u>(E)</u> One of the general aims and focus of the EU is the "integration" of gas markets. As such it is assumed that the promotion of energy trade between member states would take precedence over any efficiency argument from a domestic GB point of view. Bearing this in mind any proposal for exit reform other than the status quo option is likely to be contrary to the general thrust and intent of EU regulation concerning the harmonization of gas markets.

<u>(F)</u> Ofgems attention is again drawn to the specific comments Viridian made in response to the Second Consultation concerning compliance with applicable legal requirements and the consideration in regard to this objective of compliance with EU regulations and Directives (in particular Regulation EU/1775) where Viridian suggested that if Ofgem were to decide to proceed to implement any option other than the Status Quo option (or something very close to it), there may be conflicts with this EU Regulation. Viridian raised specific areas of concern which are still valid concerns and included;

a. **<u>Article 3, Section 1</u>** - "*cross subsidies between network users*".
b. **<u>Article 3, Section 2</u>** - "*market liquidity*" should not be restricted, nor "*trade across borders of different transmission systems*" should not be distorted or hampered..
c. **<u>Article 5 Section 2</u>** - "*Transmission system operators shall implement and publish non-discriminatory and transparent capacity allocation mechanisms which shall be compatible with the network access systems of the Member states*".
d. **<u>Article 9 Section 3</u>** - "*The application …. of Guidelines adopted pursuant to this Regulation shall reflect differences between national gas systems, and shall therefore not require uniform detailed terms and conditions of third party access at Community Level.*".

<u>(G)</u> Viridian believes that under the general objectives of the EU Ofgem should and must carefully consider the effects of any change to the exit reform in GB on the preservation of security of gas supply and the promotion of competition in the jurisdictions downstream of Moffat (Ireland, Northern Ireland and Isle of Man).

(H) A fundamental aim of any regime must be to be easily understandable, administer, easy to operate in practice, and efficient with no undue inefficiencies. Without the full details concerning the application of the flexibility issue it is difficult to comment completely here but it still appears that the regime being proposed will be substantially more complex than the existing regime, and considerably more costly to use and administer. All this to try to redistribute approximately £5 million in operations costs each year appears to be financially inefficient in the extreme and not system user friendly in nature. Serious consideration of a thorough costs Vs benefits analysis must be undertaken as on the face of it it appears the costs and hardships imposed by the proposed regime will significantly outweigh the benefits (in particular in relation to the usage of an unbundled flexibility product).

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Specific Comments:

(1) Section 1.3: The idea of investment lead times of 3 years appears reasonable and thus Viridian supports Ofgem's stance on this timing. However at the EOWG meetings later proposals from NGG appear to suggest they are now looking at investment leads times of 4 years. This is thought highly excessive and Viridian would not support any move away from the 3 years and see no justifiable logic for such, or any data which categorically proves the 4 years are necessarily.

(2) Section 1.43: Viridian does not object to the notion of users giving longer than 12 months ahead forecasts of predicted capacity requirements but one has to be extremely careful about the application of financial commitments concerning these capacity predictions as for most users "predictions" is all they can do. If such commitments are too great they (i) will undoubtly financially "burden" a company and affect their ability to do business and grow (ii) will create barriers to entry for new entrants as the monies needed to enter the market will increase dramatically (iii) will cause a change of behaviour in terms of Shipper/Suppliers contracting with Customers which will have the likely effect of locking in customers for longer and thus restricting customer movements between suppliers thus killing competition (iv) limit the risk parties are willing to take in their contracting terms and conditions (as the risk they are already taking on the capacity front is already significant) thus restricting the scope of services Suppliers will be able to offer to clients.
A huge issue with excessively long commitment periods (which 7 years is) and the financial commitments related thereto, is when one looks at retail gas suppliers to domestics, small and large I&Cs. These Shippers/Suppliers do not know with any degree of certainty what customer base they will have further than 12 months ahead (and even the certainty they have within 12 months is not 100% as customers can opt to move at any time) and as such will find dealing with this "firm" financial commitment on the basis of a "non-firm" customer base difficult (likely impossible) to cope with.
Ofgem are hereby asked to consider in greater detail how to facilitate a mechanism to cope with this issue.

(3) Section 1.45: Ofgem suggests that "a user commitment model may reduce the risk of stranded assets'. One can only assume such a suggestion is based on the notion that because there is a financial commitment attached to the longer term capacity booking that the signals given will somehow be of a better quality. However there is a slight flaw in this notion and this is that the regime as a whole the way it is being structured will force parties who wish to be sure of getting access to the capacity they need/may need to book very prudently. This will have the effect of increasing the capacity booking on the system as a whole but as the actual normal usage for most players will be some percentage of the total booked there will be stranded capacity in the system albeit booked and paid for by a party but all the same stranded as it will not be utilized most of the time. This is not thought to be the most efficient manner in which to use the system to the best effect. The restriction suggested by NGG that they only offer Day ahead firm capacity and interruptible but no longer allowing for longer term interruptible capacity bookings is worsening the potential for this issue to arise. Ofgem are asked to reconsider their apparent stance of removing long term interruptible capacity from the product offering from NGG as it is argued this product would contribute greatly towards a more fully utilizisation of the systems to the maximum extent possible. What is being suggested here is 12 months worth of interruptible capacity.

(4) Section 1.45: Further to the point (2) raised above Viridian believes that the notion that Ofgem considers "that NTS users are better placed to assess their individual future needs for NTS offtake capacity services than any other party" is fundamentally flawed when one looks at retail gas suppliers. Retail gas suppliers are only sure of their capacity requirements on a near time basis as they do not know with any degree of certainty what customers will leave or join them in the future. Hence if asked to "predict" future requirements such Suppliers are at best guessing their needs and being prudent will always "plan for growth" (due to the old adage "if you are not growing you are shrinking"). Even if such suppliers did not "plan for growth" their assessments are still only a guess. Thus feedback from such suppliers in relation to their future capacity needs for retail gas customers is likely to be very inaccurate due to the uncertainty around customer movements. However NGG who can see the total retail gas market usage and can track trends in growth of same over time, regardless of who supplies specific customers, are argued to be the entity best placed to make a true assessment of retail gas customer requirements for NTS capacity. This is argued to give a much more accurate representation of the true capacity requirements of the retail gas customers and thus avoid over or under investment, and stranded assets. Ofgem are requested to reconsider their views on this issue in light of the above logic.

(5) Section 1.46: Caution is advised to Ofgem in any apparent assumption that the model being proposed for long term user commitment will "promote security of supply". This caution is advised due to the restrictions being contemplated on the use of one year or shorter than one year firm and interruptible capacity. The current arrangements as proposed conceptually might increase security of supply by getting more pipes in the ground BUT by restrict optionality and thus the ability of a user to book capacity which is not being utilized in the system will have the effect of reducing security of supply as it reduces the access of users to capacity (even if the pipes are there). This conflict needs to be considered carefully by Ofgem so that in fact security of supply in actually improved practically and not just conceptually.

(6) Section 1.54: Viridian agrees with and supports Ofgems view that NTS Offtake capacity rights should continue to be defined on a nodal basis.

(7) Section 1.57 and 1.58: Viridian agrees with and supports Ofgems view that an license "obligation" on NGG to undertake substation is more appropriate than the use of financial incentives on NGG NTS, and that NGG should "*only be remunerated for incremental capacity to the extent all opportunities for substitution of baselines at other nodes*" have been exhausted.

(8) Substitution – to be used for Flexibility Capacity also:
Viridian strongly believes that if;

(i) there is going to be a separate or bundled flexibility capacity product (there is no detail on this in this consultation paper) and a separate flexibility capacity usage charge (or not)
(ii) the baselines for flexibility capacity are to be set either on a nodal or zonal (or global) basis,

then there should be a further license obligation on NGG NTS to use substitution in relation to flexibility capacity where additional flexibility capacity is required, even down to the timings of day ahead or within day, so as to facilitate customers requirements as and when they arise.

(9) Section 1.63: Most gas market players will be aware that there is a strong link between the Entry and Exit points when considering local system capacity capabilities, and thus baselines. As the amount of gas flowing into the various Entry Points and out of the various Exit Points will vary with time (e.g. the decline of gas being delivered at St. Fergus due to lower north sea gas production) any baselines for capacity set by Ofgem (following NGG analysis) will vary. The paper is silent on how Ofgem (or NGG) propose to deal with this issue given that the proposed booking of capacity is 7 years out and baselines can move in this period, but Viridian suggest that a policy is how this is going to be dealt with should be considered at this stage.

(10) Section 1.71 and 1.72: Viridian remain strongly opposed to the idea of a separate "flexibility" product from "capacity" (as it was commonly known to date). The reason for this is that it will be unworkable through the Moffat exit Point where there are currently in excess of 30 shippers on both sides of the Exit Point and agreeing arrangements to accommodate any new arrangements would be impossible as the risk profile surrounding doing business at Moffat will have altered dramatically beyond recognition. As there is no real detail on the single "transmission capability" product it is not possible for Viridian to express a view on whether this could work or not at Moffat but agree with Ofgems view that such a product definition would dramatically reduce the complexity of the proposed arrangements to the benefit of the market as a whole.

Viridian would strongly urge Ofgem and NGG to engage directly with shippers in Ireland, Northern Ireland and Isle of Man in order to allow such shippers an opportunity to air their concerns directly, with a view to achieving a practical workable resolution to the issues faced by, and aims of, all parties. Such downstream shippers, who would actually be parties directly affected by any Exit Reform in the UK have not had sufficient opportunities to-date to engage in such a face-to-face manner specifically dealing with Moffat but would be more than willing to engage in such a meeting.

(11) Section 1.74 and 1.75: In planning for the future Shippers, Suppliers and End Users may not be willing (or able) to commit to a "sustained demand" for 4 years in the "unconstrained period" and indeed it should not be imposed on them as this might not be needed from a NGG perspective in order to achieve the correct investment signals. An example should assist in outlining the concern in this regard.
Example: If a customer has currently (year Y) booked 100 units of capacity and in the future wishes to be guaranteed access in 3 years time (Years Y+3 to Y+7) to capacities which follow the pattern 110, 140, 130, 160 he cannot obtain this under the current proposals (he would have to book a consistent level thereby becoming exposed to overbooking of capacity). However there is a strong possibility that NGG could, if the rules were amended to allow them to, look at this request and grant such rights to such a party. NGG will be in a much better position than anyone else to know what other parties are requesting, what other parties are likely to actually utilize, etc. In other words NGG should facilitate this request in the unconstrained period if the level of investment required to facilitate it (if any) is covered (in this case if having considered all other bookings etc there is a requirement for an investment for 10 units (which is in line with the minimum "extra" amount of capacity requested (i.e. 110 in year 1) then NGG should accept the booking).
The rigid imposition of the "sustained demand" criteria for accepting a capacity booking in the unconstrained period is argued to be very unfriendly to users, and the argument for same appears could appear to be unfounded when one considers the various combinations of capacity bookings possible. There may be an argument for same if all the capacity requested in above the baseline level but this is only one scenario and there are others which should be considered so as to ensure more user friendly practices and ensure against unnecessary investment.

(12) Section 1.76: Viridian appreciates Ofgems acknowledgement that a financial commitment of 7 years will impose costs on users and is a significant (indeed quantum) change from the existing regime. It is argued there are many users, and potential users, who will not be in a position or will not be prepared to make this level of financial commitment. This is particularly true for retail gas suppliers as discussed previously in this response. This will have the effect of discouraging competition and is a potential barrier to entry into the GB Gas Market.

If such users do not participate in such bookings 7 years out then it is argued that the signals NGG get from those who do participate (if any) will be inaccurate signals, and if these alone were taken as so set NGGs 1 in 20 obligation one could find the system seriously under capacity if a 1 in 20 year actually took place. Hence Ofgem are requested to seriously consider this issue further.

Many users have advocated previously and at the EOWG meetings that there are strong arguments to suggest that not all “connectees” should have the same obligations placed on them as besides the fact that they are operationally completely different, their ability to recoup costs are also totally different. Hence Viridian do not believe that Ofgems aim of achieving a common regime for capacity bookings for all connectees is a reasonable or fair aim, and support the idea as exists today that users are treated differently as they are different.

(13) Section 1.84: Viridian believes it is inappropriate for NGG not to have the obligation to release baseline capacity in the “daily” on the day auctions. This obligation should always exist on NGG so as to maximize returns from actual usage thereby minimizing unit costs for all users.

(14) Section 1.86 and 1.87: Viridian believes that there should be very clear and transparent rules and criteria surrounding how NGG contract for interruptible contracts which are open to all to participate in. Otherwise there is the risk some users will be discriminated against.

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QUESTIONS – related to Appendix 12:

The answers below are supported by the specific comments made above in this submission.

Question A12.10:

We believe that Ofgem have gone too far in relation to user commitment and believe that a commitment of less than 7 years is more appropriate.

Question A12.11:

We believe Ofgem have not considered properly how the Status Quo model could be adapted in order to address Ofgems concerns without the necessity on introducing the complexity attached to flexibility issues.

(a) We agree that NTS exit capacity should be specified on a Nodal Basis
(b) If Capacity and Flexibility are to remain as a single product (which we would strongly support) then it appears inappropriate to specify baselines on a nodal basis. However if there is to be separate flat capacity and flexibility products it appears, based on the limited information presented to date, that flat capacity baselines should be specified on a nodal basis BUT we would argue that flexibility should not be specified on a nodal basis, but rather on a zonal or global basis.
(c) We strongly support the placing of a substitution obligation on NGG.

We believe the approach proposed for Exit will be unduly complex, difficult to administer and operate, and costly to run for end users/shippers, and thus strongly argue that the proposed regime does not strike a balance between complexity and cost.

Question A12.12:

NGG should be remunerated for incremental investments which have associated user commitment BUT we also believe that NGG should be remunerated where investments are made which are clearly justified following careful analysis taking account of all available data. This is particularly important in the case of retail gas suppliers, and shippers or suppliers will not or cannot take part in the 7 year commitment process, but analysis clearly shows trends in usage growth even though there is no firm user commitment. Viridian argues that not to do this would be very likely to cause NGG to be unable to meet its 1 in 20 obligation, and leave the system short of capacity at critical times.

Question A12.13:
Following on from the answer given to Question A12.12 above we believe to link the 1 in 20 obligation solely to firm user commitment would be a huge mistake, and lead to serious shortfalls in capacity provision. Such firm user commitments alongside NGG projections following thorough analysis of trends etc should be taken together to forecast more accurately the true system requirements.

Question A12.14:
There are merits in having stringent criteria for remuneration of investments and issues like long term buy-back contracting, long term interruptible contracting, and delivery of investments, among other issues should be considered. It is suggested that this area necessitates a separate consultation and/or discussion process to clearly define the regime that is most appropriate in this regard.

Question A12.15
Basing baselines on the practical maximum physical appears to be the most logical approach. This should however be revisited following a period of experience to assess whether this is working or not – it is suggested an initial period of 24 months should be used in this assessment.

Question A12.16:
Although it may be easier to administer the regime if the baselines were "static" for the entire price control period practically it is hard to see how the baselines could be static throughout the price control period given the interaction between the system capacity capability and the gas flowing in at Entry Points and out at Exit Points, and the considerable changes that are likely to occur in this regard over the coming years. A more realistic approach would be to have the baselines static for periods of no more than 12 months. This would then allow the baselines to more accurately reflect the true baselines in the specific areas of the system.

Question A12.17:
Revenue drives appear appropriate in this regard.

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Should the Ofgem have any queries in relation to the issues raised in this paper Viridian would be happy to answer any queries or meet to explain its thoughts.

Yours sincerely,

Derek Russell

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