TOTAL GAS & POWER LIMITED

Robert Hull
Director - Transmission
Office of Gas and Electricity Markets
9 Millbank
London
SW1P 3GE

24 July 2006

Dear Robert,

Transmission Price Control Review 2007 – 2012: Initial Proposals

Total Gas & Power Ltd is responding to this consultation on behalf of itself and also on behalf of Total E&P UK plc. TOTAL would like to acknowledge that the above document contains a number of improvements since the third consultation in March and it is clear that a number of comments made by ourselves and other respondees to that document have been taken on board.

We also continue to be appreciative of the open approach that is being taken to work with the industry through both the consultation process and through workshops/meetings. As strong proponents of the benefits of involving parties as early as possible before initial proposals are determined, we welcome the opportunities that have been provided for shippers (and others) to debate their views rather than just to rely purely on written consultation responses.

As in our response to the third consultation, we have mainly limited ourselves to comments on the proposed changes to the Entry Capacity regime. We are aware that views have been put forward to argue that the proposed cost of capital should be reduced. In particular we believe that the proposals as drafted continue to ensure that National Grid will be provided with adequate protection on any new investment that they make provided they adhere to the regulatory guidelines. As such we support the view, expressed by many, that NG is substantially protected from most of the risks that affect the generality of companies on the stock market and therefore we would support a lower equity beta than has been put forward in the proposals.

Section 6. National Grid Gas NTS (NGG NTS)

Question 6.1:

We do not believe that there has been a sufficient case presented with regard to the proposal to reduce the historical investment allowance by £75m because of supposed inefficient load related spend at St Fergus.
We assume that this relates to the NTS investment to provide summer flexibility as detailed in previous 10 year statements and as noted in the 2002/2007 price control proposals. The final NTS output figures listed in the licence reflect the maximum

physical entry capacity (winter adjusted for summer flexibility outputs) which resulted in an increased baseline for the years 2004/5 onward over and above the figures without the summer flexibility investment.
It is these capacity levels that NGG NTS have been obliged to offer in the various auctions though this price control period and as such these have formed the basis on which shippers have bid and on which assessments of incremental capacity requirements have been made.
Thus there was some industry (and regulatory) agreement at the time that this investment appeared to be required. It would also appear that the initial long term auctions confirmed a capacity demand at around this level, all capacity on offer having been sold for gas years 2005 through 2007 with additionally some non-obligated sold. Thus it would seem that at the period when NGG NTS had to make the final project commitments, there were clear indications that this level of capacity would be required and hence the investment should be allowed.

Section 11. Adjustment mechanisms and incentives: gas

Capacity Release Obligations

We are more supportive of the revised proposals with respect to the definition of entry capacity and the retention of a baseline concept. We understand that it may appear attractive to have a mechanism whereby capacity can be substituted between entry points where there is unsold capacity to entry points where shippers have indicated a sustained demand over and above the current baseline. However we still remain sceptical as to what extent this will be able to be operated in practice and what actual investment savings will result. As such we look forward to the appropriate cost benefit analysis that should be prepared to support the detailed changes to the regime as and when these are discussed in the industry workstreams. In particular one of the main advantages we perceive of the current system is the certainty provided by a stable baseline approach and we would be concerned if the new arrangements led to increased risk to shippers through frequent changes to the way capacity is apportioned across the network.

We are also concerned that there is still a lot of work that has to be done to progress the proposals to a practical level of detail and then to develop the new rules that will be needed together with the licence changes. Bearing in mind the historical evidence that suggests it can take a number of years to refine any significant new arrangements, we would still question whether the current regime, which has only been in place for a single price control period, is sufficiently ineffective such that this level of radical change is required. To this end we would have expected the cost benefit analysis for the change to have been presented at this time.

Buy-back Incentive

We look forward to the September document which will contain the detailed views on proposed changes to the buy back regime but note that it is proposed to create different incentives for incremental as opposed to operational capacity buybacks.

With regard to incremental capacity we are supportive of the principle that any costs

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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. However we recognise that this is very difficult to achieve where one party is a regulated monopoly. Thus we acknowledge the proposal to introduce an administered price under such circumstances as a means of better managing the buy back risk with NG being fully exposed to these costs. We would however have thought that, rather than fixing the price (based on an historical analysis of SAP), the price should be indexed to reflect the cost of gas at the time of the buy back.

Appendix 11 – Entry revenue drivers and baselines for NGG NTS

As stated earlier we believe there is a substantial amount of work to be done to determine a practical level of detail for the proposals. For example our initial reading suggests that there may be additional complexity that will be required to be built into Use-it-or-lose-it arrangements if capacity is allowed to be transferred using an exchange rate between entry points.

Appendix 15 re Capacity held back for short-term auctions

In our last response we detailed our concerns about the potential impact of the proposed new arrangements on the 20% of capacity that has been heldback in the long-term auctions. In Appendix 15 paragraph 1.27 Ofgem notes these concerns but states that, as no undertaking had ever been given as to the level of baselines in subsequent price controls, there was thus no commitment to the numeric value to which the 20% referred.

We believe that this is erroneous and again illustrates a misunderstanding of the effect of the 20% heldback that Ofgem insisted had to be operated in the long term auctions, despite significant opposition to this from shippers.

We accept that there was no undertaking as to the level of baselines in subsequent price controls. However this is somewhat irrelevant, as it is the baseline at the time of the auction that is significant. For example the relevant baseline at the time of the auction is used to assess whether or not there is a demand for incremental capacity. Hence, if in a long term auction bids are received going out a number of years, then for each quarter the capacity bids are aggregated and assessed against the relevant level which is 80% of the 90% of the maximum physical entry capacity detailed in the licence. Whether or not incremental is indicated, it is clear that the heldback 20% has to be offered at the relevant time. Thus if the 90% level equates to 100 units, 80 units will form the maximum level of capacity offered and if levels are requested over an aggregate of 80 then the incremental capacity tests will be used. It is clear then that whatever the level of capacity sold in the auction, a minimum of 20 units must be offered for sale in the monthly and day-ahead auctions. These 20 units are also irrespective of whether or not baselines are amended in future price controls to reflect investment/baseline adjustment and must be offered in any future year where capacity for that year has been offered in a previous auction. To do otherwise would make a nonsense of the current long-term auction regime and would seriously damage any future confidence in any amended

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regime.

Summary

Whilst we see some improvements made in the proposals to those outlined in earlier consultations we still believe there are some areas that need further thought. Also we continue to have concerns over the level of regime change that is being proposed and as to whether or not this is really necessary taking into account the inevitable level of further work that will be required to establish a practical level of detail and the subsequent uncertainty and risk that will be introduced as the new regime beds down.

We note that there are numerous references in the recently published energy Review[1] to the need to reduce regulatory uncertainty and that proposals for change should be done in accordance with the principles of Better Regulation. In particular regulation should be:

- proportionate - to the risk;
- consistent – so that people know where they stand;
- transparent – open, simple and user friendly; and
- targeted – on the problem, with minimal side effects.

We still remain unconvinced that the proposed changes to the entry capacity regime are fully warranted in line with the above principles, bearing in mind that the current regime has only been in place for a single price control period and has already supported significant changes to the gas import pattern within the UK.

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

Yours sincerely

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[1] The energy challenge Energy Review Report 2006 Department of Trade and Industry July 2006