Ofgem
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Sent by e-mail to: david.beaumont@ofgem.gov.uk

16th September 2013

Dear Sir/Madam,

Re: Gas transmission charging review: Call for evidence

Gazprom Marketing & Trading Limited (GM&T), as an active shipper on the GB gas network welcomes the opportunity to respond to Ofgem's call for evidence in its gas transmission charging review. This response is not confidential.

GM&T has several concerns about the implications of changes which may come about following this charging review; namely the potential negative impacts to market liquidity, flow responsiveness, security of supply and cost to shippers as well as end-users. Moreover the EU is currently in the middle of major reform of gas transmission charges; these will undoubtedly impact the GB market.

Therefore GM&T urges that any change to the GB charging regime prior to the implementation of the EU Network Code on Harmonized Transmission Tariffs (Tariffs NC) presumably in 2017 should be avoided and that a thorough impact assessment should be performed when the Tariffs NC will be finally approved. The reasons for this are outlined below.

- The final shape of the Tariffs NC is entirely unknown, therefore it makes no sense to make any attempt to pre-empt the Tariffs NC and make any changes before it is fully completed and understood.
- The Tariffs NC is a complicated and over-arching network code with interactions with all other network code. As such, reviewing charging arrangements in the UK before these interactions and relationships are fully understood by both Ofgem and market participants will lead to unintended consequences.
- Any changes to the GB arrangements should be made via industry lead modification process. An SCR process would not be appropriate for this review.
- Flows through Interconnector UK (IUK) have been shown to efficiently respond to price signals. As such, no change to the charging regime is required to address flow efficiency; in fact making changes where they are not needed in this way may compromise existing flow efficiency.
- Significant changes to tariffs have the potential to trigger contracts' review or break clauses across a very large number gas contracts. Therefore, it is important that any reforms to the transmission charging regime are only carried out after all of the impacts are appreciated and assessed and sufficient time is given to market participants to review their existing supply agreements. There needs to be further consideration of transition and mitigating measures.

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EU Network Codes

A key aspect of the GB gas charging landscape will be the implementation of the yet to be developed Tariffs NC, expected to be in 2017. ACER has made it clear that any changes to tariffs as a result of the code will impact capacity booked prior to 2017. GM&T wishes to impress upon Ofgem the importance of making sure that implementation of this code into the UNC is carried out only after fully understanding all of the relevant issues and potential impacts on the GB market.

Material changes to the charging regime, particularly the reform of the tariff structure including any change in the relation between capacity and commodity charges, should be proposed only after a full consideration of the impacts of the Tariff NC and only once its implementation will become binding. This is because shippers' commercial decisions will be affected not only by changes to the GB charging regime, but also changes to continental charging regimes. Enabling shippers to have the full picture of how the new rules will work will enable maximum efficient flows with minimal regulatory uncertainty.

Changes to tariffs also interact with other changes to the regulatory framework. For example, the implementation of the Capacity Allocation Mechanisms Network Code (CAM NC) may require the splitting of the Bacton ASEP for the purposes of mandatory capacity bundling with IUK and BBL interconnectors/The Netherlands and Belgium. As yet there are no firm proposals for how to split out Bacton capacity and so changes to the charging regime implemented in advance carries the risk of distorting cross-border trade, and as such undermine the aims of the Ofgem charging review.

Another issue for early implementation of the Tariffs NC is the introduction of floating capacity charges as the key revenue recovery mechanism that would follow the removal of TO commodity charges. Capacity holders will not know the final cost of their capacity until the year of use, giving little incentive to book capacity on a long term basis. This will create revenue uncertainty for TSOs, and reduces the ability for National Grid NTS to identify signals for required new investment and incremental capacity. Proposals for incremental capacity are still being developed. Issues which have been highlighted for further work include the relationship between incremental capacity, CAM and the proposed Tariff NC. As such, there is little to be gained by early implementation of GB only tariff changes, as this would only increase regulatory uncertainty.

Lastly it should be noted that there may be changes to tariffs as a result of proposals for harmonization of cost allocation methodologies. This increases uncertainty for shippers who have booked capacity beyond 2017. Current proposals for mitigating such changes to shippers' costs are very weak. This needs to be addressed as part of any Ofgem charging review, as well as during the EU Tariff NC development process.

The current regime

The current availability of capacity and pricing for short term capacity enables efficient and responsive gas flows between the UK and continental markets. Sound capacity allocation mechanisms and clear capacity baselines mean that shippers have the ability to book capacity in response to changing market conditions and commodity charges mean that all users contribute to the costs of the system when they use it. This arrangement has as benefits the efficient balancing of the system through flexibility from diverse sources of gas as well as security of supply.

Also the recent analysis published by Ofgem clearly demonstrates that the flow of gas on IUK is highly responsive to price signals when considering the market spread and associated transportation costs[1].

The charging review will not address the issue of National Grid's Allowed Revenue which represents the cost of providing capacity. Consequently the charging review will only be looking at how charges are apportioned to different types of users. As the current structure is based on longstanding Ofgem policy, any review by Ofgem must make clear why a change to pricing policy is necessary, and should take account of all the factors involved. Moreover, as noted above, we believe it would be mistaken to undertake a GB only review without looking at the wider aspects resulting from the EU reform of tariffs.

Scope of review and charging regime changes

Any changes to the GB charging regime should be raised through the standard industry-led code modification rather than through the SCR process. The shipper community fully supports the encouragement of a liquid market and competition and an industry led approach, with oversight from Ofgem (which has the power to approve or reject proposals), will lead to more informed discussion and better outcomes.

When it does come to implementation of the Tariffs NC in 2017, GM&T believes that benefits and drawbacks of having either a dual or single charging regime must be compared in a full and transparent review. Therefore due to the complexity of this question, this topic should be addressed through engagement with all different industry players impacted, in order to gain a more complete view.

As the RIIO-T1 price controls are out of scope for this review, any changes made will not have an impact on the levels of revenue recoverable by National Grid NTS, therefore changes to the GB charging regime between now and 2017 will be of no advantage to NG, but will have disruptive impacts on shippers, ahead of further changes due to the EU tariff reform.

For any additional information regarding GM&T's response to this call for evidence, please feel free to get in touch.

Yours faithfully,

Ric Lea

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[1] http://www.ofgem.gov.uk/Europe/Documents1/Interconnector%20Flows%20Further%20Analysis%20Next%20Steps%20FINAL.pdf
p.3 "Further, on those days where the market spread was higher than the marginal costs there were no FAPDs."
p.7 "Our analysis indicates that IUK's price responsiveness is reasonable (...). In March 2013, gas flows across IUK did increase quickly in response to price signals

Appendix: Ofgem's call for evidence questions

1. **What has given rise to the current balance between charges for access to the transmission network? How might this change in the future?**

   The current charging regime has come about as a way of balancing the capacity and commodity aspects of revenue recovery in a market of changing capacity booking profiles. This has enabled shippers to book capacity at short notice and respond to changes in supply and demand in the UK and other European markets. As a result the UK benefits from efficient balancing of the system through flexibility from diverse sources of gas which also helps to promote security of supply.

2. **What issues are there with the current charging arrangements?**

   Ofgem's recent publication of further analysis of interconnector flows demonstrates a very high level of responsiveness to price signals. Due to the ability to access short term capacity at short term marginal costs, GM&T feel that there is no inherent risk to security of supply; capacity is available when it is required to enable flow of gas to the highest priced market.

   Negative issues are limited to the volatility of commodity charges, though this issue could be managed without a full review of the charging regime. Furthermore, through commodity charges, entry charges to the system are borne most by those supplying gas to the system. Other concerns raised by Ofgem, such as the high cost of BBL capacity are issues which relate to the neighbouring market rather than the GB charging regime, which is currently working well.

3. **How do current arrangements give rise to these issues?**

   See answers to questions 1&2.

4. **In the event that there were to be minimal implementation of the Framework Guidelines/network codes as currently drafted, e.g. no subsequent changes at domestic points, what would be the impact?**

   There are numerous benefits and challenges to all manner of participants in the gas market to having either a dual or single charging regime. Due to the complexity of this question and the number of different industry parties impacted, this should be addressed through engagement with all of those different industry players in order to gain a more complete view of the issues.

5. **Are our goals for the review appropriate?**

   Whilst GM&T agrees it is important that there is appropriate alignment with the EU Network Codes, it is essential that the approach to GB transmission charges avoid any undue distortions.

   As such, GM&T recommends that any changes to the GB charging regime prior to the implementation of the EU Network Code on Harmonized Transmission Tariffs (Tariffs NC)

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presumably in 2017 should be avoided and that a thorough impact assessment should be performed when the Tariffs NC will be finally approved.

Any changes to the charging regime will have a significant impact on the market and it is not clear what advantages there would be to early implementation of the Tariff NC. Implementing a "GB only" charging reform is ill advised as any such changes can only be made effectively once it is clear to shippers what other charges they will face in connected European markets.

6. **How could charging arrangements better meet the objectives set out in NGG's special standard condition A5 which sets out the objectives for NGG's charging methodology?**

   GM&T's view is that the current charging arrangements continue to meet the objectives of special standard condition A5.

7. **Do the objectives set out in NGG's special standard condition A5 remain fit for purpose? If not, how should they be changed?**

   GM&T's view is that the current objectives are fit for purpose.

8. **What other suggestions do you have for the objectives of our review?**

   GM&T would like to re-iterate that the purpose of the review should be to ensure full stakeholder engagement and impact assessment of the implementation of the Tariffs NC.

9. **What is your view on the timescale for our review?**

   It is the view of GM&T that the review must be sufficient in time and detail in order to have full stakeholder engagement and consideration all interacting network codes. As such it is not recommended that changes be implemented prior to the 2017 requirement for the Tariffs NC.

10. **Bearing in mind the issues and objectives you have identified, what options should be explored to address these?**

    In order to address the GB charging regime, the only option recommended by GM&T is to use this charging review as an opportunity to bring about full involvement of stakeholders in the 2017 implementation of Tariffs NC via industry led code modifications as opposed to SCR, which would not be appropriate for such a review.

11. **What are the pros and cons of your suggested option?**

    They key benefit to this approach is that unintended consequences of network code implementation re mitigated by involving all industry players, and ensuring that no changes are made to the GB regime ahead of full EU implementation of network codes.

    There are a number of changes coming about through the implementation of several interacting EU Network codes, with the Tariffs NC likely to represent the most relevant for the GB market. It is essential therefore that any implementation be of full consideration of all impacts, actively engaging industry, and not introducing early changes.