Ofgem's Gas Transmission Charging Review – Call for evidence

Submission by GDF SUEZ Energy UK-Europe

9 September 2013

(I) Introduction

Thank you for the opportunity to comment on your call for evidence with regard to the review of Gas Transmission Charging. Please find our response below which is not confidential.

(II) Answers to Consultation Questions

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

1. The current GB transmission charging framework allows for NGG to recover its missing costs of capacity (under-recovery) from the application of a commodity based charge. The application of this commodity based charge has been applied prevalently (at Entry) in recent times and to such an extent that this now recovers a significant and increasing proportion of the transmission entry charges as indicated in Appendix 2 of the Ofgem document.
2. The consequence of using commodity charges as a mechanism to recover unrealised revenues for the TO is the uncertainty that this approach introduces to gas shippers. Largely the uncertainty arises from the variability of the revenue recovered from medium and short term capacity holdings and as such the costs attributed to some shippers who have booked long term QSEC are influenced by the bidding behaviour of other shippers in the medium and short term auctions. This is because the commodity charges are applied to all gas flows at each affected entry point irrespective of the capacity product or mix of capacity products they have booked.
3. Holders of long term capacity therefore face unforeseen costs brought on by others.

Question 2. What issues are there with current charging arrangements? For example:-

a) ***Does the charging structure strike the right balance between incentives to use capacity efficiently and investment?***
b) ***Is capacity available when needed?***
c) ***Do the current charging arrangements help NGG to plan network investment?***
d) ***How do our current charging arrangements interact with those in neighbouring markets? What is the impact of these interactions?***

4. There are unprecedented levels of spare capacity available overall on the GB gas system and this has arisen due to historical factors. The UK currently has headroom entry capacity in excess of +50% of 1-in-20 peak day demand as a result of changing supplies sources and this increased investment has encouraged a greater interconnection with adjacent markets.
5. It is difficult to assign a charging mechanism that is accurate where there is an abundance of new capacity combined with existing capacity, and given this environment it is perhaps the right time to initiate a review the GB charging arrangements. The objectives of any review must encompass a number of factors

including; the efficient use of existing capacity, combined with the right incentives to attract new capacity where this is economic. Risks for existing shippers and investors must be minimised as far as possible in any considerations in order to improve confidence and reduce uncertainty.

6. Some neighbouring markets have a different approach to capacity pricing. For example, in NL, French, and Belgian markets, long term capacity is sold at a discounted rate to short–term capacity. This model, which has the opposite effect to the GB pricing system, has proved to:
    a. Stabilise TSO tariff recovery and minimise the risk of under-recovery;
    b. Provide a less distorted functioning of the market with a more balanced incentive to firm and interruptible capacity;
    c. Dis-incentivise free-riding and reduce the cross-subsidy element;
    d. Improve fairness and certainty to those who initiated the long term investment.

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

7. The current arrangements if left unchanged may continue to exacerbate the issues that have been highlighted and hence lead to greater uncertainty particularly where this is linked to short-term under recovery, and GB market attractiveness.

Question 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?

8. It is clearly a priority to implement measures which are consistent with the implementation of the framework guidelines/network codes ahead of any other changes relating to domestic points. However, any changes must be mindful of the ACER draft framework guidelines which stipulate that there should not be discrimination between domestic and transit flows.
9. Moreover, with no subsequent changes at domestic points, it would mean the amount to be recovered at interconnection points must be kept in the same order of magnitude as today. Ofgem identified that entry costs at Bacton could represent a barrier to GB Security of Supply, in effect adding a "trading fee" to landing gas in GB.

Question 5. Are our goals for the review appropriate?

10. Please see (Q2) point 5 above.

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

11. It may be more appropriate for GB to consider a simplified charging regime which is more relevant to a mature market. The ACER tariff guidelines will become more relevant and these recognise that cost allocation is based on observed costs where major investments have already taken place and based on an incremental cost model only where there is a developing grid.
12. The balance between entry and exit fees (both exit to customers and exit to other hubs) may also be reassessed in the current context of a more mature market, of need for more imports, and of the necessary implementation of the framework guidelines/network codes. Indeed, shifting charges from entry capacities to exit capacities could help to solve the "trading fee" issue exposed above, and could stabilize revenues and tariffs.

13. Shifting from a commodity charge to a capacity charge for all points, including exit to customers, could also be explored, under the condition that specific arrangements should be implemented for modulated customers, for instance taking into account a reference annual consumption, which is stable.
14. Adapt the ratio between short term and long term charges in favour of the latter. In particular, the revenue equivalence principle – that compensate long term bookings from being flat, against modulated short term bookings – could help reducing significantly the under recovery issue, and also cross subsidies between long term and short term shippers.
15. Minimisation of entry and exit costs to storages could also be assessed. In terms of cost reflectivity, as storages are a efficient way to limit dimensioning flows, they may represent more a saving than a cost for the network. Moreover, storages are key infrastructure for GB security of supply, and their development should not be deterred by excessive network entry and exit fees.
16. Additionally increased transparency and predictability in the charging models would be welcomed in order to promote a wider understanding of the GB charging regime and to enable shippers to better predict how tariffs will evolve.

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

17. No comment.

Q8. What other suggestions do you have for the objectives for our review?

18. We broadly agree with Ofgem's objectives of fair incentives, compliance with EU frameworks/codes and to avoid undue distortions at interconnection and other system points.

Q9. What is your view on the timescale of our review?

19. It is difficult to comment as other than the very next steps in the process it is not possible to determine Ofgem's intended timescale for review from the information contained in the call for evidence.

Q10. Bearing in line the issues and objectives you have identified, what options should be explored to achieve these?

20. In summary, to take into account a fundamentally changing context (more mature market with much less investment needed, need for more imports, and the necessary implementation of the framework guidelines/network codes), the following options could be assessed :
    a. Shifting charges from entries to exit;
    b. An assessment of the revenue equivalence principle in relation to entry capacity charging;
    c. Shifting to a capacity charge, with some adjustment for modulated customers;
    d. Minimizing entry and exit tariffs from storages;
    e. Ongoing principles for tariff models should be simple, predictable and transparent.

Q11. What are the pros and cons of your suggested options?

21. We have set-out some options for consideration in the context of the review and have explored the potential upsides and downsides as part of our response to questions.

End of response to questions.

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