

Ofgem Consultation on CAM Implementation at Bacton

Submission of Oil & Gas UK

Summary

Oil & Gas UK, the upstream industry association, is pleased to respond to the Ofgem consultation document of 13 June on the implementation of the EU CAM network code in Great Britain. This response supplements the submission we made in December 2013 at the first stage of consultation.

We endorse the principle of seeking to minimise the impact of CAM on the GB regime by restricting its application to IPs and we accept that that it will consequently be necessary to split Bacton entry capacity into two new ASEPs. However, we have reservations about the basis of the capacity split since it is, in our view, essential to avoid obstacles to future development of gas fields and depleted field storage facilities in the Southern North Sea (SNS). It is important that the capacity allocated to the proposed new UKCS ASEP is capable of revision to accommodate such future offshore developments in order to realise the government's aim of Maximising Economic Recovery (MER) on the UKCS.

Ofgem's current position and UNC Mod 501 represent a fundamental change in the entry capacity contracts at Bacton. As Ofgem itself points out in its consultation document, 'the current Bacton ASEP will no longer exist' and that 'two new entry points' will be created at Bacton. We agree with this description of the proposed change. Furthermore, neither of the two new capacity products, separately or jointly, is equivalent to the current capacity product at the single Bacton ASEP. We therefore submit that parties which hold entry capacity rights beyond 1 November 2015 should be entitled to return their holding to National Grid without penalty. In our view, the proposed re-allocation process proposed by National Grid is neither fair nor legally sustainable given the proposed fundamental change in the capacity products at Bacton. We support the principle embodied in Centrica's proposed UNC Mod 501A which seeks to remedy this unfairness.

The splitting of entry capacity at Bacton will have an unavoidable adverse impact on trading flexibility. This may be exacerbated by the uncertainty over future tariffs at both new proposed ASEPs arising from the EU Tariffs network code and Ofgem's GTCR. There has been some informal discussion with the industry about ways to mitigate this effect (e.g. through reform of the over-run regime) and we believe that discussions should if possible be continued and intensified. Minimising the adverse effects of CAM implementation deserves further attention.

Treatment of sold entry capacity at existing Bacton ASEP

We contend that that the proposed route to implementation of CAM effectively abolishes the single Bacton ASEP and replaces it with two new ASEPs. Indeed, Ofgem's own description of the change is identical to this interpretation. The capacity rights acquired under UNC rules at the single Bacton ASEP include the flexibility to deliver gas from UKCS and non-UK sources. This flexibility is not available from the non-fungible holdings of capacity in the two new ASEPs. Consequently, we believe that holders of existing capacity beyond 1 November 2015 should have the right to terminate their contracts without penalty and return the capacity to National Grid.

Furthermore, we understand that most of the capacity with entry rights after 1 November 2015 was first acquired, typically in QSEC auctions, before the development and adoption of the CAM network code and even before the Third Energy Package was agreed. Most primary purchasers of Bacton entry capacity cannot be reasonably expected to have been in a position to anticipate the changes now being proposed at Bacton. This reinforces our contention that holders should be entitled to terminate existing contracts.

It may indeed be the case that CAM applies to existing contracts but the contracts entered into for capacity at the single Bacton ASEP cannot be fulfilled after the proposed split into two new ASEPs. It is regrettable that Ofgem has not offered any clear legal guidance on this important issue. However, its acknowledgement that the single Bacton ASEP will no longer exist after splitting points clearly towards a legitimate termination of existing capacity contracts with extend beyond 1 November 2015. This would have the beneficial effect of accelerating the process of bundling of capacity on the two interconnectors.

We do not agree with the proposals for re-allocation of existing holdings contained in UNC Mod 501. There should be no expectation that capacity holders will need to re-assign all their existing booked capacity rights between the two new ASEPs. We agree with the proposal in UNC Mod 501A that capacity holders should be entitled to return all or part of their capacity holding to National Grid. Any unreturned capacity should not be allocated in a way which may leave capacity at a new ASEP in which the holder has no interest.

The proposed capacity split should take account of the future potential of the SNS.

There is no evidence of physical or contractual congestion of Bacton entry capacity at present. However, we are concerned that Ofgem's proposed capacity split (73% IP / 27% UKCS) may in future disadvantage offshore developments in the SNS if the basis of the allocation to the IP ASAP is explicitly linked to the maximum technical capacity on the two interconnector pipelines and proves difficult to revise in the future as a result. The reference in Article 6 of CAM to maximum technical capacities appears to refer to a simple IP, not a complex entry point like Bacton incorporating both a domestic ASEP and an IP. We therefore suggest that Ofgem reviews the split and seeks to avoid future inflexibility in the attribution of baseline capacities to the two new ASEPs.

Despite the long-term decline in gas production from the SNS, we should not assume that demand for entry capacity at the new UKCS ASEP will decline inexorably in the future. Further discoveries like that of the Cygnus field (due on stream in 2015/16) and success of the SNS Rejuvenation Project being undertaken by PILOT would both serve to slow or arrest the decline. In July 2014, HM Treasury launched a comprehensive fiscal review of the UKCS which may result in new incentives for the development of known 'tight gas' resources in untapped deep horizons in the SNS. If tight gas exploitation proved were to be economic after the introduction of new fiscal incentives, demand for entry capacity at the UKCS ASEP at Bacton would rise significantly. This potential upside to SNS production is not included in the baseline figure in National Grid's Ten Year Statement. Depleted field storage projects might also provide additional demand for entry capacity after 2020 if the UK were to introduce financial incentives for new storage capacity or identified the need to replace its existing offshore storage capacity. The issue of the adequacy of existing UK storage capacity is unlikely to be permanently settled and it is important that new arrangements at Bacton do not unnecessarily delay or raise the cost of new SNS storage projects.

Substitution of capacity between domestic ASEPs.

As we mentioned in December 2013, there is a risk that by giving priority to IPs in the allocation of the entry capacity, the UKCS ASEP at Bacton will become more exposed to an unanticipated substitution of baseline capacity to another ASEP. We therefore repeat our suggestion that the implementation of CAM is accompanied by a review of the methodology used for substitution of baseline entry capacity.

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