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Dear Alena,

RE: Gas Transmission Charging Review: Ofgem policy position on future charging arrangements

The Gas Forum welcomes the opportunity to comment on Ofgem's GTCR policy position. We have elected to distill our response to focus on the key points which we believe should be addressed before Ofgem finalises its overall position.

- Ofgem helpfully acknowledges the limitations of the modeling work and that it should not be relied upon to provide anything beyond a guide to the relative impacts of the policy options. On this basis, we find it hard to reconcile this accepted wisdom with some of the observations recorded in the report. Throughout its impact assessment document, Ofgem quotes precise numerical outputs, which by its own admission are tenuous. The Gas Forum is concerned that, contrary to the concerns raised by us about the robustness of the model, Ofgem has elected to justify its conclusions, primarily, on the recorded outputs. That being said, we have no desire to totally discredit the model as we welcome any attempt to quantify the impacts of any policy change, however, to make any claim that the relative impacts on Users can be properly examined by the model outputs, without a full and proper assessment of the wider repercussions is somewhat disingenuous and also misleading.
- Ofgem has identified a number of areas where it believes the current charging methodology is inconsistent with policy aims and/or market efficiency. When challenged at the recent Ofgem workshop, it is clear that Ofgem's main concern relates to the lack of contribution made by certain Users to the historical costs incurred by the TSO. This may, or may not be valid, but to push forward with radical reform on the basis of a single

(and in our view, unsubstantiated concern), may not justify the undesirable impacts and costs to the industry that we expect these reforms to have.

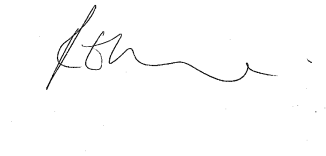
- In relation to the issue of user contribution to historical costs, we would make the following observations. Firstly, it cannot be said that the revenue allowance provided for in each formula year is an accurate determination of all historical costs, either in terms of the level of costs incurred, or the period to which they have been allocated. Allowed revenues are precisely that and incorporate a number of components which include the value of the asset base and ongoing costs/incentives (notwithstanding the fact that parts of the network have been effectively written down and, arguably, stranded). Allowed revenues are agreed at the start of each price control period, providing a guaranteed income to underpin the monopolistic provision of network services. The way in which revenues are recovered should, where possible, support the workings of the downstream gas markets. This means that a balance must be struck between cost-reflectivity, equitability, practicality, stability, security, compatibility and impact on consumers. The Gas Forum is concerned that Ofgem's proposals do not consider all of these components with equal weight and need to be revisited, to ensure that the net benefits across all of them are sufficient to justify change. In order to aid a more objective assessment of the Ofgem Policy Position, we have set out our initial observations in Appendix 1.
- In relation to the other objectives, it is understood that capacity over-booking is not a problem in an unconstrained network and indeed can lead to improved efficiencies in the wholesale market if it permits faster, physical response to commodity price signals. It is also understood that the imposition of a floating capacity charge will not have a positive impact on cross-border trading, as User booking behaviour will ensure that the level of under-recovery remains significant. Just like the commodity charge, the floating charge will be set each year and will fluctuate, in accordance with system-wide User booking activities. The "creation" of short-term locational signals will be achieved by the imposition of a non-100% short-term discount; however, in a system which is expected to be unconstrained going forward, one must question the usefulness of such signals in any case. Furthermore, there is little reason to suspect that short term capacity signals are of use to the TSO when planning its network, in any case.
- Ofgem's proposals will create some re-distributional, financial impacts on Users which will be significant and (in many cases) impossible to mitigate. For example, those with long-term capacity holdings, or those who have no choice but to purchase long-term holdings, due to the mechanics of the incremental capacity release methodology, may face additional costs; particularly where capacity utilisation is below a certain, undeterminable level. The Gas Forum is concerned that this outcome may fall foul of a number of the objectives we set out in point 3 above - in particular; equitability, practicality, security and compatibility. The creation of two classes of User should not be overlooked - those who are able to take steps to militate against charge increases, e.g. by profiling bookings to effectively commoditise capacity charges and those who can't,

due to wider rules regarding incremental capacity. In addition, the exclusion of gas storage sites from the floating capacity charge will create its own challenges, particularly at those entry points which “share” flows from storage and other sources of gas.

In conclusion, the Gas Forum does not believe that the evidence provided by Ofgem is sufficient to justify the radical change proposed and we encourage it to work with industry to reconsider its position. Certainly, the model outputs and the single policy aim which it believes the change will deliver are not a suitably robust basis for change.

We trust that this response provides clarity with respect to our position and welcome any feedback to gasforum@gemserv.com.

Yours sincerely

A handwritten signature in black ink, appearing to read 'R Fairholme', with a stylized flourish at the end.

Richard Fairholme

Chairman, Gas Forum Transmission Charging Review Group

Appendix 1 – Performance of charging approaches against Gas Forum objectives

Objective	Current charging approach	Policy Position
Cost reflectivity	Combination of pay as book and pay as use, with increasing likelihood of pay as use	Pay as book only.
Equitability	Some users able to minimize capacity payments. Those unable to rely on ST capacity pay capacity element and commodity element (based on flow)	All Users pay capacity charges irrespective of flows. Those with low flows make a greater unit contribution. Greater costs for those unable to rely on ST bookings, but with low flows
Practicality	Implemented, easy to manage as under-recovery is flow-based	Adds complexity as inconsistent with rules applied on booking and treatment of shared entry points containing storage flows
Stability	Dependent upon aggregate levels of bookings and flows	Dependent upon aggregate bookings compared to use of individual capacity holdings
Security	No flow, no costs. Only ongoing cost is LT booking. Allows zero priced option on ST capacity purchases	Ongoing costs irrespective of flows. Additional costs for low levels of capacity utilisation
Compatibility	Consistent with commodity based wholesale market. Reflects costs incurred in an unconstrained network	Inconsistent with wholesale market and creates classes of User based on ability to profile bookings
Consumers	No effect	No effect

Key – Green = positive effect, Orange = neither positive/negative effect