Ofgem's Consultation – Gas transmission charging review: Part II – our assessment of potential impact

Eni UK Limited (hereinafter **eni**) welcomes the opportunity to participate in this consultation and provides its response as follows.

Summary

eni recognises the proposed changes would be required to ensure harmonised transmission tariff structures for gas in the UK in line with European TAR NC but, considering the impacts of the proposed substantial intervention in the entire UK entry capacity charging regime, believes that a deeper assessment of the simpler alternative of a dual regime of TAR NC implementation at IPs only, combined with the simple change of ending discounts for short term entry products within the current regime, is needed. **eni** believes this alternative could adequately address Ofgem's concerns of ever rising commodity charges and the lack of capacity signals to NGG in the current regime.

However, if the proposed fully floating price regime were to be implemented at all entry points of the UK transmission network, **eni** believes that ending discounts for short term entry products would be needed to reduce instability of capacity charges. In any event the new price regime would significantly impact on the cost position of existing LT capacity holders and require appropriate mitigating measures to be put in place (for example, a one-off reset option mechanism available for all current holders of long term capacity) in order to ensure a level playing field among all shippers and to avoid undue cross-subsidy.

Chapter 2

What are your views on our proposed changes?

Given the system is now developed sufficiently that it may be characterized as one which is presented with few problems of growth or congestion, **eni** agrees with Ofgem's premise that the transmission charging regime's primary concern should be allocating costs of investments among network users in ways that accord with the notions of fairness.

The primary and simplest action to re-establish fairness would be to eradicate discounts for short term entry products and ensure that short terms users, at the very least, do not pay less for their capacity than those users who have taken on long term capacity commitments and supported the network development now enjoyed by all.

The approach and strategy of shippers with regards to their capacity bookings have been strongly modified by the current non-congested environment. Compared to other operators, shippers locked-in to existing long-term capacity contracts are already penalized by not now being able to take full advantage of short term profiled bookings. The continued offer of discounted short-term capacity products significantly worsen this scenario: the holders of existing long-term contracts could sell their unused capacity only at a loss on the secondary market and, through the fully floating capacity charging mechanism, would be charged with compensating the possible under-recovery of allowed revenues caused by the increased bookings of discounted short term capacity products. The combination of all these elements creates a discrimination between different network users of gas transmission capacity, thereby distorting competition and causing cross-subsidization to the benefit of short-term users at the detriment of long-term users.

Indeed there are arguments in favour of a premium for short term products to ensure the continued opportunity of appropriate long term signals for entry capacity development.

The ending of short term discounts would maintain the entry capacity product as it is understood today and substantially reduce the commodity charge which would continue to be paid by those users who actually flow gas to meet consumer demand. **eni** believe this simple step would effectively address Ofgem’s concerns.

However Ofgem’s policy proposal of GTCR entails a much more radical change which fundamentally alters the long term entry capacity product.

Today securing long term entry capacity at a known price provides an option to flow. That option can then be exercised hour by hour recognizing that the additional cost to flow is the known commodity charge. Known at the moment of decision to flow, but varying every six months depending on consumer demand, supply patterns and potentially prompt capacity discount levels.

Ofgem’s concern with overbooking of capacity and its effects on the commodity charge comes not from overbooking of the long term product but of the short term products which today are available at a 100% discount.

The fully floating price approach that Ofgem is proposing creates a completely different entry capacity product, requiring the long term user to make a different investment decision reflecting a significantly adjusted risk/reward balance. Today the maximum downside risk of a long term capacity investment decision, should gas not subsequently flow, is known at the time of investment decision and fixed at the capacity charge level successfully bid.

In future the downside risk would be unknown as it would be the sum of the capacity charge bid and the flexible top-up charge which is dependent on consumer demand, supply patterns and prompt capacity discount levels through time. The resultant uncertain financial exposure could be a multiple of that in the current regime (see Figs 9 & 10 in the impact assessment) which makes any long term capacity investment decision significantly more difficult to make. Consequently players will be driven ever more towards short term products, weakening security of supply and potentially driving up consumer prices above those they otherwise would be.

Moreover the introduction of a fully floating capacity charge in the UK system determines a radical change of the transmission cost position of holders of existing LT capacity contracts. They signed their contracts under a completely different charging regime than the proposed one and, as said above, the application of the new price approach to their contracts would upset their expectations on the evolution of their incurred transmission costs, undermining their cost position and unfairly discriminating them versus future capacity holders.

If this is to be Ofgem's chosen path then, given such a fundamental shift in the long term capacity product risk/reward structure and the required investment decision, in order to put all network users on the same level playing field all current holders of long term capacity must be given the opportunity to return their capacity and rebook in the light of the new product risk/reward scenario.

Do you agree with our reasons for rejecting the alternatives? If not, explain why.

It is not clear why the simple alternative of a dual regime with required TAR NC changes to charging regime limited to apply only at IP's and keeping the domestic regime as is, whilst at the same time removing all discounts for prompt products, should be rejected.

This could be a simpler change to implement, share historic costs more equitably across all users and lower commodity charges significantly and should be usefully further assessed.

Chapter 3

1. Do you think we have identified the relevant quantitative impacts?

2. Do you think we have modeled the impact appropriately?

3. Do you think we have identified the relevant qualitative impacts?

4. Do you have any further evidence of the potential impacts of our proposed changes not covered by our analysis?

Much of the analysis and modeling is, as Ofgem recognises, potentially highly complex with many moving parts across the next 15 years. The results of the analysis presented are necessarily only indicative and in **eni**'s view do not identify differences in outcomes that usefully serve to differentiate the benefits of the various options modelled.

At the heart of any GTCR decision are a number of simple choices to deliver the allowed revenue to National Grid. The key driver of the size of the variable element, commodity charge today and top-up capacity charge tomorrow, is the scale of the discounts offered for prompt products. In the proposed new world, as the analysis demonstrates, if the discounts remain then as long term bookings expire new bookings will move ever more towards short term bookings which ultimately will ensure we replicate today's position whereby the fully flexible top-up capacity charge would be the equivalent of today's commodity charge.

In the intervening years of the new regime the cost lowering effect provided to short term users today by long term capacity holders who do not fully utilise their capacity will be increased and prohibitively so for holders of long term capacity with flows significantly below their bookings. One has to question why is this desirable in a system with excess capacity and which is struggling to generate useful capacity signals?

Given the understandable shortcomings of the modeling, Ofgem rightly implies that the qualitative impacts may be just as important to consider as the model outputs. Ofgem asserts that transaction costs associated with cross-border trade of gas are likely to be lower under the fully-floating charges which should help better facilitate trade in gas, and support security of supply in GB. There is no supporting evidence for this statement as the transaction cost reduction will simply result from the choice of the level of prompt discount and the enhanced benefit flowing to short term users from long term capacity holders who don't flow, paying the top up charge.

Chapter 4

1 Do you agree with our assessment of how our changes would align with our principal objective and statutory duties?

2. Can you provide any evidence that supports or would contradict our assessment against one or more of them?

3. Do you think there are other duties or aims that we should assess these changes against? If so, what are your views on how changes might affect them?

A concern must be that this uncertain exposure on capacity costs will make it that much harder to attract investment in infrastructure, including new or expanded regas terminals, in future. That's not desirable for the UK's long term security of supply or consumer prices. Investors will not see the UK as an attractive place to do business if large and disproportionate, regulatory, retrospective charge increases are made to historic long term capacity commitments.

In conclusion it should be recognized that NGG's annual allowed revenues are derived ultimately from current consumers providing revenues to market participants. It seems wholly sensible and appropriate that any shortfall in allowed revenues should be met by those companies receiving revenue through flowing gas and benefitting from the transmission service.

It should not be expected to be met by those who have made historic long term capacity commitments, already providing secure revenues, but who are today unable to attract gas flows.

eni believes that in fully meeting its principal objective, statutory duties and desired outcomes, described in the policy position impact assessment, Ofgem should further consider a less dramatic intervention. That is, implementing TAR NC at interconnectors only and maintaining the current charging regime whilst eradicating short term capacity discounts. However, should the proposed intervention be implemented, Ofgem should also carefully take into due consideration the impacts of the charging system change on the cost position of existing holders of LT capacity contracts and provide for appropriate mitigating measures to ensure that they are not penalized and discriminated against compared to other network users, for example by giving them the possibility to hand back their already contracted capacity rights and re-book under the new regulatory scenario.