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Dear David,

**RE – Impact assessment of UNC modifications 0501V, 0501AV, 0501BV, and 0501CV ‘Treatment of Existing Entry Capacity Rights at the Bacton ASEP to comply with EU Capacity Regulations’**

This response to the above-referenced consultation is on behalf of the Centrica group of companies, excluding Centrica Storage Limited.

**Summary**

We consider the Ofgem Impact Assessment to be seriously flawed, in a number of important respects:

- The assessment gives undue weight to a relatively minor impact on TO Entry Commodity charges and its hypothesised impact on competition, without considering the evidence from a much larger background increase in those charges over the last few years – which have been characterised by healthy competition in the wholesale gas market and increasing levels of investment in the development of new North Sea gas production facilities.
- It gives insufficient weight to a number of other factors, including the grounds on which Alternate UNC Modification proposals have been based.
- It makes ill-founded assumptions about gas shipper behaviour as a result of capacity hand-back and gives little or no weight to either UKCS producers’ desire for firm Entry capacity or the impact of bundled cross-border capacity arrangements on future capacity bookings.
- In particular, it does not sufficiently discuss the role that ‘User Commitment’ for NTS entry capacity plays in sending market-based signals for efficient investment on the part of National Grid, failing to consider the impact that the ‘forced’ allocation of existing Entry capacity bookings (without due redress) is likely to have on the future User Commitment regime and the quality of investment signals provided to National Grid, whether at Bacton or at other ASEPs.
- Such undermining of the User Commitment regime would therefore seriously impair relevant objectives (a) and (d) (i) of the network code, i.e. the efficient and economic operation of the pipeline system, and securing of effective competition between shippers.
- We note that the EC and ACER are agreeing to a grandfathering clause in the EU Tariff Network Code so that existing capacity contracts are not impacted by the Regulation. The

principle, based on what a shipper could have reasonably foreseen when booking the capacity, should also be employed by Ofgem with respect to Bacton entry capacity.

- The consultation document fails to take sufficient account of Ofgem's proposals for reform of current gas transmission charging methodology, which would lead to the complete abolition of TO Entry Commodity charges as from October 2017.

As a consequence, we do not consider that the Impact Assessment presented for consultation provides a sound or sufficiently comprehensive basis for evaluating the relative merits of the various UNC modification proposals.

We now take each of your key questions in turn below.

### **Have we identified the relevant quantitative impacts?**

The greater part of Ofgem's quantitative analysis has focused on the possible impact on the TO Entry Commodity Charge which is relevant but is perhaps afforded a disproportionate amount of coverage in the consultation paper. The only other quantitative data appears to be the cost estimate for introducing UNC modification 0501CV.

#### TO Entry Commodity Charge

We agree that, subject to Ofgem's Gas Transmission Charging Review, there is the potential for an increase to the TO Entry Commodity Charge if any of UNC modifications 0501AV, 0501BV or 0501CV is implemented. The consultation considers whether such an increase could have an impact on:

- Competition in the wholesale market
- Consumer bills
- Encouraging new entrants to the market

It appears that Ofgem have concluded that there could be an impact on competition and have some concern that an increase in the TO Entry Commodity Charge could affect the ability for potential new entrants to enter the market. You consider that there will be minimum impact on consumers' bills.

We will comment on the modelling approach and assumptions you make in answer to the further questions below.

Here, we would like to explore the possible quantitative impact based on the cost estimates that you have presented. To do this, we will review the scenario that you present as having the most significant impact on TO Entry Commodity charges, i.e. the maximum potential impact from implementation of UNC modification 0501AV. We focus on the estimated average annual increase to the charge (over the period 2015/16 to 2025/26) and the estimated maximum annual charge over the same period. To help us consider the possible quantitative impact, we have reviewed these estimated charge increases against historical changes to TO Entry Commodity charges and have summarised this in the following table:

Table 1: Actual TO Commodity Charges, how they vary over time and how Ofgem’s worst case estimated increases compare

- all prices quoted are in units of pence per kWh
- “Ofgem’s Mean Estimate” is the estimated average annual increase to the charge between 2015/16 and 2025/26 for the UNC0501A scenario, i.e. 0.00124 pence per kWh
- “Ofgem’s Maximum Estimate” is the highest annual estimated increase to the charge over the 2015/16 to 2025/26 period for the UNC0501A scenario, i.e. 0.00199 pence per kWh

Charge Effective From:	Actual Charge	% Change on Previous Value	Ofgem’s Mean Estimate as % Change on Previous Value	Ofgem’s Maximum Estimate as % Change on Previous Value
April 2011	0.0198			
October 2011	0.0232	+17	+6	+10
April 2012	0.0257	+11	+5	+9
October 2012	0.0331	+29	+5	+8
April 2013	0.0244	-26	+4	+6
October 2013	0.0249	+2	+5	+8
April 2014	0.0297	+19	+5	+8
October 2014	0.0431	+45	+4	+7
April 2015	0.0451	+5	+3	+5

The third column in the table shows in percentage terms how the TO Entry Commodity charge has changed every 6 months since April 2011. Most changes have been increases and these increases have ranged from the very small (2%) to the very high (45%). The final two columns indicate, again in percentage terms, what additional 6-monthly changes might have occurred had UNC Modification proposal 0501AV been implemented at that time.

What is immediately clear is the significant volatility already witnessed in the charge over time with the general trend being for it to increase. The change in the charge levied from October 2014 from the previous April 2014 figure is most notable. In terms of absolute values, only in October 2013 do Ofgem’s estimated charge changes exceed the change actually implemented by National Grid.

The consultation paper suggests that changes to the TO Entry Commodity Charge of the order of 3-5% could have adverse impacts on competition and on new entrants entering the market. We are not aware of any such adverse impacts arising from the significant changes to the charge in recent years, yet the TO Entry Commodity Charge has increased by 128% between April 2011 and April 2015. If the impacts highlighted by Ofgem were actually occurring then arguably this should have been most visible following the dramatic increase to the charge in October 2014 yet no analysis has been conducted to assess this. Given that we have looked at possibly the most significant charge increases as estimated by Ofgem, we conclude that there is no evidence to suggest that competition in the wholesale market will be adversely affected nor will potential new entrants be deterred from entering the market should any of the competing UNC modification proposals be implemented.

## **Have we modelled the impacts appropriately?**

The modelling approach for assessing the potential impact on the TO Entry Commodity charge appears reasonable but in attempting to draw conclusions on possible impacts it fails by omitting to consider how National Grid's charging methodology may change in future. In particular, no impact assessment has been made as to how the implementation of a new entry capacity charging regime (as envisioned in Ofgem's Gas Transmission Charging Review) would affect transmission charges.

We are of the opinion that Ofgem will likely be minded to implement a "floating" entry capacity charge regime from possibly late 2017. Floating capacity charges might be expected to reduce TO Commodity Charges to a significant extent, if not completely. In this case, the impact of interest would be on the level of entry capacity charges and what effects the implementation of each of the competing UNC modifications might have.

The lack of such an assessment of what might occur under a floating entry capacity charge regime (and one that Ofgem appear to be strongly advocating) is a major shortcoming and is inconsistent with Ofgem's overall scope of work. Without this, the tentative conclusions presented in the consultation document are potentially very misleading.

## **Have we identified the relevant qualitative impacts?**

Although the general modelling approach to assessing impacts on the TO Entry Commodity charge appears reasonable, a number of modelling assumptions (and hence possible qualitative impacts) do not.

### Hand-back of Capacity

In considering those UNC modifications that include capacity hand-back options, Ofgem have opined that shippers could hand back all of their capacity in the belief that there will be sufficient (interruptible) capacity for them to re-acquire but via auctions with zero reserve prices. Whilst this could happen we think it is unlikely because:

- Producers delivering gas from the UK Continental Shelf will want, as far as possible, to guarantee deliveries to the NTS so as not to lock out their gas and therefore destroy much higher value than would be obtained by avoiding entry capacity charges;
- Shippers importing gas via the BBL and IUK interconnectors will need to procure capacity from National Grid's adjacent TSOs and our expectation is that these adjacent TSOs will not offer (unbundled) interruptible capacity unless their firm capacity is sold out;
- The firm capacity to be procured from adjacent TSOs will favour bundled capacity products and so will encourage interconnector shippers to book firm NTS entry capacity at the Bacton Interconnection Point.

The recent announcement by Interconnector UK of a successful sale of long-term GB import capacity lends weight to our argument that shippers will not follow a simple strategy of minimising or avoiding entry capacity charges.

### Security of Supply

Ofgem suggest that Users may choose to minimise their exposure to redistributed costs (in the guise of increased TO Entry Commodity charges) by flowing less gas and thereby having an undesirable impact on security of supply.

As we have argued above, we do not believe that the estimated changes to the TO Entry Commodity charge will result in a behavioural impact and we therefore conclude that there will be no adverse impact on gas security of supply.

Security of supply is enhanced by having efficient and fair access to the NTS. Physically, there will be no change to the NTS from the splitting of the Bacton ASEP but any perceived risk in not being able to enter gas for UNC/ contractual reasons will not facilitate supply security. Should the reallocation of existing Bacton entry capacity result in an oversubscription (or near total sell out) at one of the two new ASEPS then this could be detrimental

#### Competing on the basis of capacity versus commodity

The consultation paper suggests that competition in the gas wholesale market will be negatively impacted by any hand-back of capacity by Bacton shippers, with a resultant increase in the TO Entry Commodity charge, because the Bacton shippers can then choose strategies for sourcing gas from different system entry points to minimise costs whilst shippers incurring the TO Entry Commodity charge cannot do similar because the charge is uniform or postalised. We consider the potential maximum change on the TO Entry Commodity charge to be relatively insignificant and something that will have no impact on competition (as argued in response to the first question above). Furthermore, we note that implementation of a floating capacity charge regime would essentially nullify the concern you have raised.

#### Potential impact on new entrants

As we reasoned in our answer to the first question above, there is no evidence to suggest that increases in the TO Entry Commodity charge have reduced or will diminish the appetite of potential new market entrants. We note that investment in new UKCS field developments actually increased sharply from 2011-14<sup>1</sup>, at a time when TO Commodity charges were rising significantly. This clearly indicates that a much more modest (and short-lived) rise in those charges is unlikely to be a barrier to entry in this respect. Also, any move towards a floating capacity charge regime will have a major bearing on this.

#### Reduced entry capacity flexibility at Bacton

Much of Ofgem's assessment on the "potential impacts on competition of reduced flexibility in using Bacton entry capacity" focuses on the ability, under different scenarios, of shippers being able to access sufficient entry capacity for their purposes on a given day.

In the scenario where shippers are assumed to reassign capacity to the Bacton UKCS but want to flow via the Bacton Interconnection Point, Ofgem conclude that interruptible capacity is likely to be available to the shipper at the Bacton Interconnection Point, in some cases at zero price and in other cases at a price more likely to be lower than the price received for any firm Bacton UKCS capacity shippers may have sold on the secondary market. Therefore, the general conclusion by Ofgem is that the impact on reduced capacity flexibility will be relatively low. However, the assessment does not consider how or why shippers may have procured the long-term capacity they currently hold so as to optimise their flows of gas via Bacton from both the UKCS and interconnectors over a longer timeframe. Decisions on how to manage capacity requirements for long-term supply contracts are not made on a daily basis as this might otherwise result in risk premiums being built into sale or purchase prices.

Ofgem's assessment may also have benefited from a consideration of how shippers will access capacity from the Adjacent TSOs (BBL and IUK). If such capacity is not available on an unbundled firm basis then the prospect of shippers making practical use of unbundled interruptible NTS entry capacity will be diminished.

In the scenario where shippers are assumed to reassign capacity to the Bacton IP but at the time of use they want to flow via Bacton UKCS but not Bacton IP, Ofgem are probably correct in their suggestion that the probability of Bacton UKCS selling out is higher than for Bacton IP capacity.

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<sup>1</sup> See Oil and Gas UK Activity Report 2014:  
<http://www.oilandgasuk.co.uk/cmsfiles/modules/publications/pdfs/EC040.pdf>

### Permitting the return of capacity

The consultation document suggests that allowing a return of capacity (albeit under particular circumstances) may set a precedent and may result in shippers perceiving that they can book capacity and later hand it back to the transporter without penalty. Our view is that shippers would be taking a huge gamble if they procured their capacity on such an assumption and in the hope that future modifications to the network code would absolve them of their obligations. With regard to associated concerns about false signals for capacity being provided to NGG (and possibly unnecessary investment costs) we would expect such risks to be covered by an appropriate financial User Commitment obligation.

On the subject of User Commitment, the consultation document fails to adequately discuss the possible impact of Bacton shippers being forced to simply reallocate their existing capacity holdings, without redress, between the two new Bacton ASEPs as proposed by Modification 0501V. Modification 0501V essentially tears up long-term contractual commitments between shippers and National Grid but does not allow shippers reasonable scope to re-assess their capacity requirements in light of the new gas entry arrangements and value of the capacity at Bacton. Implementation of Modification 0501V would therefore signal the high risk to shippers of committing to long-term capacity holdings. Such a precedent would have a negative impact on future long-term capacity bookings so that the benefits ensuing from the User Commitment regime (providing signals to National Grid for the efficient use of, and investment in, the gas transmission system) would be undermined.

Such undermining of the User Commitment regime would therefore seriously impair relevant objectives (a) and (d) (i) of the network code, i.e. the efficient and economic operation of the pipeline system, and securing of effective competition between shippers.

We note that the EC and ACER are agreeing to a grandfathering clause in the EU Tariff Network Code so that existing capacity contracts are not impacted by the Regulation. The principle, based on what a shipper could have reasonably foreseen when booking the capacity, should also be employed by Ofgem with respect to Bacton entry capacity.

### European Network Code Implementation

We still believe that enabling shippers to hand back capacity will better facilitate the implementation of capacity bundling at the Bacton IP than simply requiring reallocation of existing capacity to the two new Bacton ASEPs. For example, and as envisaged by each of the four competing modification proposals, if the Bacton UKCS ASEP is over-subscribed then under Modification 0501V shippers will have capacity forced on them at the Bacton IP ASEP. This would be inefficient and detrimental to the effective implementation of the CAM code.

### Regulatory governance

We note that all four modifications have been recommended for implementation by the UNC Panel which accords with Ofgem's view that from a regulatory governance perspective any of them could be implemented or all of them rejected.

### Efficient use of the NTS

Clearly, by splitting the current Bacton ASEP into two there is the risk of eroding efficient access to the NTS and in creating artificial constraints. We accept that the split has to happen to meet the requirements of the CAM code but the impacts on existing Bacton shippers as well as future Bacton shippers need to be fairly addressed.

**Is there further quantitative and/or qualitative evidence of the potential impacts of the proposed changes not covered by our analysis?**

We believe we have answered this in response to the earlier questions.

Please contact me if you would like to discuss this response.

Yours sincerely,

Graham Jack  
Regulatory Manager