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Dear David,

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

By way of overview, Centrica Storage Limited (CSL) considers that Ofgem's Impact Assessment (IA) does not provide a fair and reasonable representation of the potential quantitative or qualitative impacts of the proposed modifications. In particular, CSL considers that the IA does fully explain or justify the potential impacts on the TO Entry Commodity charges that modifications 501AV, 501BV or 501CV are likely to have, nor does the IA provide the relevant context (i.e. historical changes in TO Entry Commodity Charge, and prospective changes to the Network Charging Arrangements in GB) for interested parties to make an appropriate assessment of Ofgem's conclusions.

Further, as CSL has noted in both its Modification Proposal (501BV) and its response to the consultation on the 501 modifications, by not permitting capacity hand-backs, Ofgem is significantly increasing the sovereign (regulatory) risk associated with investing in the GB energy market. In this case, Network Users have made a significant financial commitment while accepting a moderate level of risk associated with the Uniform Network Code (UNC) changing. However, the magnitude and potential financial implications of the changes to charging arrangements at Bacton are unprecedented and could not have been reasonably envisaged when many parties bid for entry capacity at Bacton. In order to maintain the integrity of the User Commitment model, it is vital that party have confidence that the risk of change is predictable and reasonable. When regulatory changes result in contractual changes which are beyond reasonable expectations, it is important that the effected parties can reassess their commitment.

CSL notes that this principle appears to have now been accepted by ACER and the European Commission in relation to the EU Network Code on Tariff Harmonisation (TAR NC). CSL understands that the revised code will recognise that those parties entering contracts before the EU Third Energy Package came into force will not be subject to floating charges if their agreement was based on a fixed price for capacity. By way of extension, since the changes at Bacton are so significant and could not have been envisaged, it would seem appropriate to permit some form of capacity hand-back.

The following sections respond to Ofgem's specific questions.

Have we identified the relevant quantitative impacts?

CSL considers that Ofgem's emphasis on quantitative impacts on TO Entry Commodity Charges to be disproportionate and Ofgem has not provided sufficient context in order to draw the conclusions of potential negative impacts on competition and creating a disincentive for investment. This lack of context makes it difficult for interested parties to comment on Ofgem's conclusions.

CSL agrees that it is indisputable that TO Entry Commodity Charges will increase should Bacton Users be able to return capacity and that this means that those costs will be smeared across Network Users under the assumptions that Ofgem has used. CSL also agrees that the increase in TO Entry Commodity Charges are unlikely to impacts on consumer bills.

However, CSL notes that in the worst case scenario for capacity hand-back (i.e. 501AV with 100% capacity handback) the potential increase in TO Entry Commodity Charge is in the order of 2.7% each year between 2015-16 to 2025-26). CSL calculates that between April 2011 and April 2015 that the actual TO Entry Commodity Charge increased by 127% in nominal terms (avg of c.32% per year). CSL is not aware that these changes have resulted in reduced competition nor dis-incentivised investment in the GB gas market.

Given the relative impact of the different levels of possible capacity hand-back under modifications 501AV-501AC, CSL does not consider that the IA provides sufficient evidence to support Ofgem's interpretation that permitting any of the modifications which all for capacity hand-back would have a negative impact on competition and/or discourage market entry.

Have we modelled the impacts appropriately?

CSL considers that the conclusion Ofgem have drawn from their modelling work have limited value due to the fact that significant changes to network charging arrangements that will result from Ofgem's Gas Transmission Charging Review and the implementation of the EU NC TAR. These changes potentially include: the introduction of floating capacity charges; the removal of short-term capacity discounts and no discounts for interruptible services if there is no/little likelihood of interruption. These measure significant change how network charges in GB and in turn make Ofgem's modelled impacts redundant.

CSL considers that it is disappointing, and potentially misleading that Ofgem has not provided some any form of quantitative or qualitative assessment of the potential impacts of a capacity hand-back from these significant and impending changes to network charging arrangements in GB. Without such information, interested parties cannot draw a reasoned opinion about the various proposed modifications.

Have we identified the relevant qualitative impacts?

CSL has some concerns regarding the nature of the qualitative discussion surrounding the TO Entry Commodity Charging as well as some of the other qualitatively based conclusions drawn by Ofgem.

First, in relation to the capacity hand-back options, Ofgem has not attempted to consider the likelihood of the different levels of capacity hand-back. CSL considers that in all cases, the worst case scenarios presented by Ofgem are highly unlikely. This is because, it is likely that at least some parties would not return all capacity or seek to 'game' the hand-back framework on the basis that they need the certainty provided by holding firm capacity. This is because relying on interruptible or short term products are unlikely to provide sufficient certainty for companies who have invested significant sums in production assets and/or contracting physical gas delivery into GB. Further, as noted above, the potential changes to the transmission charging regime in GB means that the incentives to return capacity will be significantly weakened. CSL considers that Ofgem should have been more explicit by either de-rating the potential returned capacity under the different modifications and/or indicating a more likely impact on TO Entry Capacity Charges.

Second, Ofgem does not consider that there is any evidence to support claims that not allowing for capacity hand-back will have a negative impact on long term bookings. CSL considers this position disingenuous. The reality is that although all market participants have been aware of the EU Third Package, it is only in the last year or so that market participants have been able to appreciate the breadth and financial implications of European Network Codes on transmission charges in GB. Given this, it is not surprising that Ofgem cannot see, and has not been provided with direct evidence that not allowing for capacity hand-back will have a negative impact on long term bookings. In reality, CSL would be surprised if potentially capacity users do not start factoring in a significant risk premium into their modelling for capacity bookings. Ofgem does not appear to appreciate the potential magnitude of the costs associated with capacity and how they can significantly impact the economic viability of projects.

Third, Ofgem's concerns that the (insignificant) increase in TO Commodity Charges from allow capacity hand-backs could have a negative impact on security of supply as parties seek to reduce their exposure to the increased commodity charge are misplaced. As noted, the actual commodity charge impact is negligible and are unlikely to influence behaviour, particularly when compared to other recent (eg. cash-out reform) and impending changes (eg Ofgem's GTCR).

Finally, CSL considers that enabling shippers to hand-back capacity will permit capacity to be bundled at IPs sooner and thereby make the network more efficient better facilitate the implementation of capacity bundling at the Bacton IP than simply requiring reallocation of existing capacity to the two new Bacton ASEPs.

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

CSL notes that Ofgem has chosen not to consider the training, system and administrations costs for those Users that are required to hold capacity at an Interconnection Point (IP) and which is traded on different IS platform.

Please note that this response is not confidential.

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

Yours sincerely,

Antony Miller
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