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17 June 2015

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'

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

We note that the Authority has requested stakeholders' views on the Impact Assessment so that the Authority can take them into account in deciding which, if any, of the four UNC modification proposals to implement. In particular we understand that the Authority would like to receive comments on the following questions:

- Have we identified the relevant quantitative impacts?
- Have we modelled the impacts appropriately?
- Have we identified the relevant qualitative impacts?
- Is there further quantitative and/or qualitative evidence of the potential impacts of the proposed changes not covered by our analysis?

We have sought to answer those questions in this response document insofar as is possible without conducting our own modelling of the quantitative and qualitative impacts of the proposals discussed in the Impact Assessment.

1. Overall Comments

The four proposals (0501V, 0501AV, 0501BV and 0501CV, each a "**Modification Proposal**" and together the "**Modification Proposals**") for modifications to the Uniform Network Code (the "**UNC**") that Ofgem is now considering fall to be considered in the context of Ofgem's decision to:

(a) close down the existing Bacton ASEP, at which existing capacity holders hold long-term capacity that is fungible between the UKCS and European interconnectors;

(b) allocate Bacton IP enough capacity to match precisely the technical capacities of the European interconnectors; and

(c) allocate what capacity remains to Bacton UKCS.

In the remainder of this response document, we refer to this as the "**Bacton Split**".

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Ofgem's decision to implement Commission Regulation 984/2014 (Capacity Allocation Mechanisms) ("**CAM**") by means of the Bacton Split gives rise to potential impacts on the market and market participants that now require to be addressed: without suitable mitigation measures, the Bacton Split stands to have a hugely detrimental effect on existing capacity holders. The opportunity to take those steps is now before Ofgem, as it decides on which of the Modification Proposals to implement.

Modification Proposals 0501AV and 0501CV are the only Modification Proposals that adequately protect the rights of long-term entry capacity holders. Modifications 0501V and 0501BV, on the other hand, fail to provide such protection and therefore cause a number of outcomes that the UNC relevant objectives (the "**Relevant Objectives**") are intended to prevent.

(a) Interconnectors and their users will be allocated all the capacity they will need at the Bacton IP without having to give a price signal, thus conferring a significant competitive advantage on interconnectors and their users relative to others in the market.

(b) Existing long-term capacity holders at Bacton are given an arbitrary, one-off opportunity to split their capacity between the two new ASEPs for the remainder of their contract.

(c) Existing long-term capacity holders at Bacton can no longer use their capacity flexibility, thus removing a crucial factor in its current and prospective value and restricting their ability to switch between gas sources according to market conditions.

(d) Existing long-term capacity holders at Bacton are unable to return any unwanted and devalued capacity, thereby conferring on the interconnectors and their users a significant competitive advantage, and potentially giving rise to either "sterilised capacity" or abundant interruptible capacity at Bacton UKCS or Bacton IP, which obviates the incentive for shippers to book firm capacity at either entry point and constitutes a cross-subsidy by existing capacity holders to other shippers.

(e) The above amounts to a serious and unjustifiable interference with long-term capacity holders' property rights.

(f) Existing long-term capacity holders at Bacton are in a worse position than are holders of capacity at ASEPs that are not being split, which amounts to a serious competitive disadvantage.

(g) That competitive disadvantage has further, knock-on consequences for the market more generally: it creates uncertainty and inefficiency; it disincentives future investment; and, ultimately, it risks security of supply.

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On the other hand, Modification Proposals 0501AV and 0501AC do allow the return of capacity, and thus avoid these negative consequences by allowing existing capacity holders to compete with interconnectors on the same terms.

The negative consequences of preventing the return of capacity are not solely a concern for capacity holders, however: they are also factors to which Ofgem is legally bound to have regard. In choosing between the Modification Proposals, Ofgem is required to consider carefully its public law and statutory duties, including those under the Gas Act 1986. Those duties include giving proper consideration to the Relevant Objectives, which include ensuring the efficient and economic operation of the pipe-line system, the securing of effective competition, and the provision of reasonable economic incentives for relevant suppliers to ensure security of supply.

The task now before Ofgem is, therefore, a critically important one. However, Eni has serious concerns about the process that Ofgem has followed thus far in deciding on the modifications to the UNC. In particular, Ofgem has now produced an impact assessment that, for the reasons explained in the body of this response document, is deficient in detail and analysis. Eni's view is that, in order to comply with its legal obligations, Ofgem must now conduct a proper assessment of the impact of each of the Modification Proposals. Once that assessment has been conducted, Eni's view is that it will confirm that the only course lawfully open to Ofgem is to choose one of the Modification Proposals that:

(a) makes provision for existing capacity holders to return capacity, which is the only reasonable and proportionate response to the materially altered value proposition for such capacity holders; and

(b) to the extent that such capacity is retained, makes provision for continued use of the current flexibility.

2. Background

Following a statutory consultation on the implementation of the CAM, Ofgem notified gas transporters, shippers, interconnectors and other interested parties, on 10 February 2015, that it was effecting the Bacton Split through changes to the gas transporter licence held by National Grid Gas plc.

On 19 February 2015, the UNC Panel submitted a Final Modification Report to Ofgem, which recommended all four of the Modification Proposals.

On 1 April 2015, Ofgem decided to conduct an impact assessment, and sent the Final Modification Report back to the UNC Panel to make the changes that were necessary to reflect the new timetable.

Eni welcomed Ofgem's decision to conduct an impact assessment. Taking into account the backdrop described above, as well as the requirements of the Utilities Act 2000, it was quite clear that the need for strong empirical analysis of the Modification Proposals

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by way of an impact assessment is critical. Eni is disappointed, therefore, that the Impact Assessment does not contain sufficiently detailed quantitative and qualitative analysis of the impact of each of the Modification Proposals on long-term capacity holders. As such, it does not amount to an assessment of the likely impact of implementing the proposal, as is required by the Utilities Act 2000.

As a result of the lack of detailed analysis in the Impact Assessment, combined with the fact that Ofgem has allowed the UNC Panel to "recommend" all four of the Modification Proposals, Ofgem cannot consider itself now to be in a position to provide a cogent decision as to which of the Modification Proposals is most suitable and best achieves its statutory objectives. Urgent work is therefore required in order to ensure that Ofgem can make a legally robust decision.

3. Specific Comments

Quantitative Analysis

The quantitative analysis contained in the Impact Assessment is extremely limited; the data is premised on simplistic assumptions and fails to provide adequate support for Ofgem's conclusions.

One of Ofgem's stated objectives in the Impact Assessment is to *"look at the value of capacity that can be returned under each of the proposals … [and to] … examine the distributional impacts of capacity return on the costs faced by shippers, potential impact of creating new classes of network user and the impacts of reduced flexibility in using existing Bacton capacity."*

Ofgem's conclusion is that:

> *"Where capacity is handed back, all other things being equal, the amount of TO allowed revenue collected by NGG through locational capacity charges will decrease. Therefore there will need to be an increase in the non-locational TO commodity charge to recover the shortfall in TO allowed revenue. This will be applied equally to all users at all NTS entry points based upon their flows."*

One of the fundamental principles of the current gas transmission capacity regime is the "ticket to ride" principle. This principle is that shippers should acquire or purchase capacity rights to cover their flows of gas onto the National Transmission System ("**NTS**") and that there should be no incentive for a shipper to flow gas in excess of its entry capacity rights (overrunning). Overrun charges are designed to: (a) provide strong commercial incentives to purchase capacity before flowing gas; and (b) ensure the costs of a participant overrunning are targeted back to that shipper.

In this regard, we note that the quantitative analysis undertaken by Ofgem is premised on *"the charging methodology as it currently is today (i.e. excluding any possible changes from Ofgem's Gas Transmission Charging Review or from the Tariff Network code)."*

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This approach is fundamentally and legally flawed. As Ofgem is well aware, the UK current charging regime, as those of all other EU member states, is required to align itself with the EU Tariff Network Code (the "**Tariff Code**") in the next few years (currently by 1 October 2017). This point has been recognised by Ofgem itself: in launching the Gas Transmission Charging Review ("**GTCR**") in July 2013, Ofgem declared that *"a review was due because of ongoing significant structural changes to the GB gas market since the system was designed, and because emerging EU legislation to harmonise transmission tariffs (TAR NC) might lead to significant changes to the GB regime in the next few years."*

However, in spite of having recognised the significance of the ongoing changes to the GB gas market in other contexts, Ofgem has entirely failed to take those changes into account in the Impact Assessment, instead basing its analysis on a snap-shot of the current – and entirely different – position. In other words, the analysis is predicated on an assumption that the market and regulatory context in the coming years will be unchanged. That assumption is known to be false.

For example, one potential outcome of the GTCR is a revision of the current discounts applied to short-term capacity products that, as Ofgem acknowledges, in the current non-congested environment represent an unfair allocation of network costs as between shippers to the extent that short-term users pay, in aggregate, much less for their capacity requirements than users who have taken long-term capacity positions to support the development of the NTS now enjoyed by all shippers. If such discounts were reduced (resulting in a more proportionate allocation of network costs to short term users), it would follow that shippers would simply not have the ability to, as suggested by Ofgem, buy *"capacity with zero reserve price, only if they need the capacity."* This is a very important point. Flexibility as to source of gas is a highly valuable component of the existing capacity product at Bacton; and one to which differing levels of value can be ascribed through time. The only way of properly quantifying the impact of the Bacton Split (and of the resultant Modification Proposals) is to model the effect through time, taking account of possible scenarios resulting from the ongoing review of the charging methodology and possible shipper behaviours post implementation of the Bacton Split. However, this important analysis has not been undertaken as part of the Impact Assessment. As such, the Impact Assessment entirely ignores a highly relevant factor when considering the Modification Proposals and, for this reason alone, is fundamentally flawed.

Furthermore, the quantitative analysis included in the Impact Assessment:

(a) does not quantify the material adverse impacts resulting from the allocation of capacity to the Bacton IP matching, precisely, the maximum technical capacity of the interconnectors (in particular, no quantitative analysis has been undertaken by Ofgem in relation to the impact of such an allocation on existing capacity holders at Bacton, including those competing with the interconnectors);

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(b) uses simplistic assumption that long-term capacity holders will replace long-term capacity rights with interruptible capacity, notwithstanding varying degrees of risk appetite and firm downstream delivery obligations such long-term capacity holders may or may not have; and

(c) does not map the quantitative advantages or disadvantages of each Modification Proposal (including on the broader capacity market at Bacton) such as the cross-subsidy resulting from existing capacity being incorrectly priced in the event of Modifications 0501V or 0501BV being selected.

Accordingly, we suggest that Ofgem should undertake suitable scenario-based modelling to satisfy itself of the impacts of the various Modification Proposals over time, based on divergent shipper behaviours (including behaviours attributable to lesser risk tolerances). This analysis, at a minimum, needs to be undertaken in order for Ofgem to form a reasoned assessment of the Modification Proposals and to make a decision that is fully compliant with its statutory and public law duties.

Qualitative Analysis

Potential impact on consumers of increased TO commodity charges

There are two constraints on capacity at Bacton: physical constraint and commercial constraint. The former constraint is self-evident. The latter constraint arises in the market where a user forms a commercial view on the risk of capacity being "sold out" and purchases capacity to gain certainty in relation to its ability to flow into the future. It is irrational to ignore this commercial constraint in forming a view that shippers will simply hand-back long-term capacity and replace it with interruptible capacity, which is a fundamentally different product. This is particularly the case given the significant dislocation of the capacity market at Bacton flowing from the allocation capacity as between Bacton UKCS and Bacton IP. It is, plainly, incorrect to deduce that shippers will behave in such a way into the future in a manifestly different capacity environment, where, owing to nominations as between Bacton UKCS and Bacton IP, significant commercial and/or physical constraint may exist. In the Impact Assessment, Ofgem refers to capacity hand-back resulting in a re-distribution of charges to other users by way of increased TO commodity charges. For example, Ofgem states:

> *"NGG will recover the same TO allowed revenue regardless of whether it is recovered from capacity or commodity charges. This means that the sum passed through to the shipper community as a whole, and ultimately consumers' bills, will not change depending upon which, if any, modification is implemented. However as stated above we think that there will be a reduction in competition in the wholesale gas market due to some aspects proposed under UNC0501A, UNC0501B or UNC0501C – particularly the possibility to hand back capacity. Reduced competition in wholesale markets can result in increased prices for consumers.*

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We also consider that there may be a risk of further charges being passed on to consumers under UNC0501A, UNC0501B and UNC0501C. We are concerned that creating an environment where capacity return is allowed (freely or under particular circumstances), may result in shippers perceiving that they are able to book capacity safe in the knowledge that it can be returned without penalty if circumstances change and it is no longer required. This may create false signals for incremental capacity at entry points and lead to unnecessary network development by NGG. The cost for this will be met ultimately by consumers. We note the comments in the UNC workgroup that this is such a unique set of circumstances such as not to create a precedent. We do make a judgement on whether this is true or not but we need to remain alert to these risks in our decision making."

This entirely disregards the fact the Bacton Split represents a significant structural dislocation of capacity at Bacton: any downside associated with a nominal increase in the TO commodity charge is likely to be substantially outweighed by the material adverse impacts of Ofgem failing to properly mitigate the negative consequences of the Bacton Split. For example, if Ofgem were to select Modification 0501V or 0501BV for implementation:

(a) the loss of fungibility would seriously undermine the value of existing long-term capacity products and the ability of holders to use those products, the effect of which would be that existing long-term capacity products would no longer be correctly priced (the new capacity environment representing a radically different flexibility and value proposition);

(b) the removal of existing capacity holders' contractual rights to elect how to use capacity as between Bacton UKCS and Bacton IP, as well as the imposition of a requirement to make a one-off election between the two new ASEPs, would amount to a substantial interference in the possessions of such existing capacity-holders, which are protected under the European Convention on Human Rights;

(c) the proposals' disregard for the existing rights of long-term capacity holders may deter shippers from entering into long-term capacity commitments (in case the regulatory goalposts are moved on them), which may have negative implications for price signals to National Grid NTS should it need to develop new entry capacity in the future; and

(d) existing capacity holders who have their capacity allocated at unwanted terminals in case of oversubscription and who cannot now use their capacity in a flexible way would have to send an incremental investment signal to regain the long-term capacity lost at their desired ASEP, which would be likely to:

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(i) result in lower utilisation of already booked capacity at the unwanted ASEP; and

(ii) lead to artificial constraint, and to unwarranted and inefficient applications for incremental capacity at Bacton ASEP (which may, in turn lead to unnecessary investment by National Grid NTS in response to artificial price signals).

Furthermore, we note that Modifications 0501V and 0501BV do not adequately address:

(a) the discriminatory effect on existing capacity holders of this incorrect pricing of capacity, which, by its nature, would have the effect of conferring a cross subsidy on the rest of the shipper community;

(b) the radical change to the Bacton capacity market through the creation of an asset-specific ASEP for interconnector assets in circumstances where no long term signal or market price for guaranteed long-term availability of entry capacity has been made;

(c) the fact that a user may be allocated capacity at a new Bacton ASEP at which that user is unable to utilise the capacity, enabling National Grid NTS to release more discretionary and interruptible capacity, which in combination would represent a cross subsidy by existing capacity holders in favour of the rest of the shipper community;

(d) the fact that existing capacity holders would be prevented from exercising their existing rights to flexibly support flows via any sub-terminal contained within the Bacton ASEP, the effect of which would be that capacity bookings would need to be replicated in order to achieve the same gas flows, resulting in a disproportionately high allocation of capacity costs to such users; and

(e) the concept of existing capacity holders at Bacton being subjected to discriminatory treatment vis-à-vis holders of capacity at other ASEPs:

(i) whose existing rights are not being retrospectively altered;

(ii) who may continue to use their capacity flexibly to support flows via any sub-terminal contained within a single ASEP; and

(iii) whose existing rights are not subjected to a diminution in value.

These adverse effects – i.e. the misallocation of costs across users, resulting in unjustified cross-subsidy, as well as the lack of an efficient price signal – would clearly undermine effective competition.

These problems with Modifications 0501V and 0501BV are not factors that Ofgem can ignore. Ofgem needs to implement a Modification Proposal which establishes a value

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and flexibility balance for existing capacity holders and a level playing field for all shippers utilising Bacton (and indeed the NTS). Such a Modification Proposal needs, at a minimum, to:

(a) address the incorrect pricing of capacity products for existing capacity holders at Bacton;

(b) rectify the competitive imbalance posed by the creation of an asset-specific ASEP for interconnector assets and their users in circumstances where no long term signal or market price for guaranteed long-term availability of entry capacity has been made;

(c) preserve the flexibility inherent in the existing capacity products to prevent artificial constraint and price signals which would be likely to result in a cross-subsidy by existing capacity holders in favour of the rest of the shipper community; and

(d) eliminate the unfair and inefficient pricing of existing capacity both at the new Bacton ASEPs and more widely as compared to other ASEPs which are not subject to "splitting" (thus no distortion of the capacity market as between shippers).

A key feature of the capacity booking regime is encouragement of long-term capacity bookings to underpin efficient investment in the NTS. Against this backdrop, Modification 0501CV responds to the unique challenge by restoring a value and flexibility balance in the context of substantive structural changes designed to deliver a CAM as simply as possible. Similarly, Modification 0501CV recognises the unique and fundamental change at the existing Bacton ASEP through the creation of an asset-specific ASEP for interconnector assets in circumstances where no long term signal or market price for guaranteed long-term availability of entry capacity has been made (where the initial price of capacity on allocation to the Bacton IP is demonstrably zero).

We note Ofgem's comments with respect to the availability of interruptible capacity at Bacton:

> *"We note that at Bacton there is currently a substantial amount of capacity that is unsold. It is difficult to know until one of the four modifications proposed is implemented and existing capacity is reassigned to either Bacton IP or Bacton UKCS the amount of unsold firm capacity that will be available at the two new entry points. However, given current levels of flows we know that there will be substantial amounts of interruptible capacity made available. Given that both interruptible capacity and within-day sales of firm capacity are currently offered at a zero reserve price then we could assume that if there is the option to hand back capacity shippers may hand back the majority of their capacity and buy it at an auction with zero reserve price only if they need the capacity.*

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> *We have also considered what impact returning capacity could have on competition in the wholesale market. In our view, returning capacity could redistribute transmission costs from Bacton users to other NTS users and increase transaction costs for new entrants. We set out our thinking in more detail below.*
>
> ……
>
> *We noted earlier that due to zero reserve price auctions and availability of capacity at Bacton IP and Bacton UKCS we would expect a large proportion of shippers holding capacity at Bacton to hand back most of their capacity and then buy any capacity as and when they need at zero reserve price auctions in the short term. If they handed back capacity under UNC0501AV, UNC0501BV or UNC0501CV and bought the same capacity at zero price to flow in the future, they would pay zero capacity charges and a higher TO entry commodity charge. NTS users at other entry points would be subject to an increase in their overall charge rate as they would become liable to pay the higher commodity charge but see no change in the capacity charges they are liable to pay."*

However, it is unclear to us what evidence this conclusion is based upon. Is Ofgem suggesting that shippers should side-step booking firm capacity in favour of flowing on a short-term basis to avoid capacity charges? If so, does this not sit inconsistently with the "ticket to ride" principle of which Ofgem is the proponent? Is Ofgem making a recommendation to users in terms of how they should react to the Bacton Split?

In our view, the statements quoted above entirely fail to take into account the reasons for which users, with varying degrees of risk appetite, purchase long-term capacity.

Materiality of increased TO commodity charges

In addition to the fundamental omissions from the Impact Assessment, the analysis that has been included is worryingly thin. The best example of this is Ofgem's conclusion that the impact on the TO charge is a material reason for not implementing 0501A or 0501C.

However, even based on Ofgem's modelling, the overall impact on the TO commodity charge is negligible, particularly relative to the likely material adverse impacts associated with Modification 0501V or 0501BV being selected by the Authority. Even in the most extreme example relating to Modification 0501AV, whereby all existing capacity entitlements are returned, Ofgem's quantitative analysis indicates a 2.76% overall increase in the TO commodity charge. Adopting a more pragmatic analysis of shipper behaviour, the actual impact on TO commodity charges is likely to be materially lower.

However, even if the impact on the TO commodity charge were as high as 2.76%, that is a minimal increase compared to historic increases.

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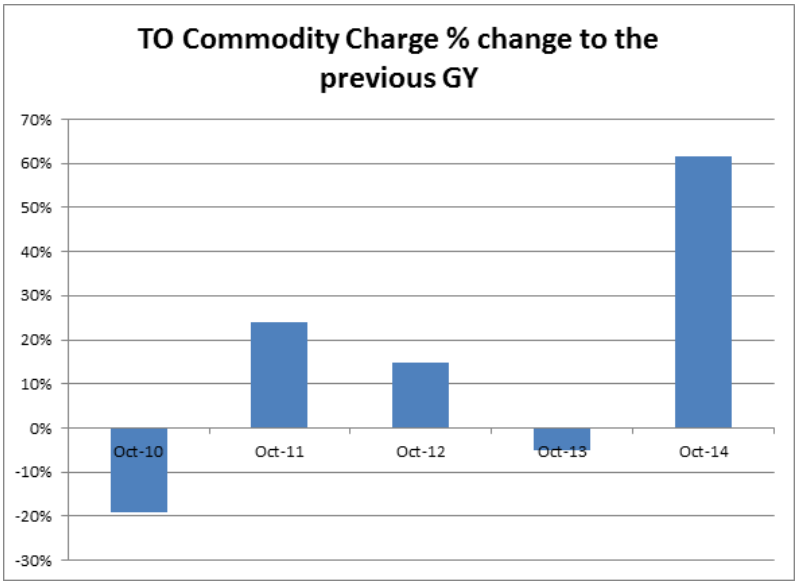
For example, between the 2013 and 2014 gas years, the TO commodity charge increased by 62%. This is reflected in the graph below, which demonstrates the volatility of the TO commodity charge over the preceding five gas years (GY)[1]:



	Oct-10	Oct-11	Oct-12	Oct-13	Oct-14
% change to the previous year	-19%	24%	15%	-5%	62%

Charges in p/kWh					
Month	TO Entry Commodity	GY	Average charge per GY	Absolute change to the previous GY	% change to the previous year
Oct-09	0.0249	Oct-09	0.0222		
Apr-10	0.0194				
Oct-10	0.0174	Oct-10	0.0186	-0.0036	-19%
Apr-11	0.0198				
Oct-11	0.0232	Oct-11	0.0245	0.0059	24%
Apr-12	0.0257				
Oct-12	0.0331	Oct-12	0.0288	0.0043	15%
Apr-13	0.0244				
Oct-13	0.0249	Oct-13	0.0273	-0.0015	-5%
Apr-14	0.0297				
Oct-14	0.0431	Oct-14	0.0441	0.0168	62%
Apr-15	0.0451				
Oct-15	0.0486				

Source: National Grid, NTS Charging Statements as published on http://www.gasgovernance.co.uk/ntscharges, Eni interpretation

[1] The change is expressed as the % change to the previous GY. For example, the Average Charge for GY15 was in absolute terms 0.0441p/kWh or 62% compared with the previous GY14 when the average TO Commodity Charge was 0.0273p/kWh (the sum of October 14 TO Commodity Charge - 0.0431p/kWh and April 15 TO Commodity Charge - 0.0451 divided by 2).

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As the data on the previous page demonstrates, the TO commodity charge is, by its nature, highly volatile. Relative to historical volatility, it cannot be said that the maximum identified increase in the TO commodity charge is material. In this vein, we strongly disagree with Ofgem's comments regarding the discouragement of new entrants into the wholesale market:

> *"We are also concerned that an increase in the rate of the TO entry commodity charge could affect the ability for new entrants to enter the market and supply gas to the NTS.*
>
> *Returning capacity would mean new entrants would face higher transaction costs – through upward pressure on the TO entry commodity charge - to access the NTS due to the actions of incumbent NTS users.*
>
> *This could discourage new entrants as they would have to pay a higher share of the socialised cost of providing NTS access and infrastructure. This could be a particular issue at interconnector points where shippers have greater choice to flow gas depending on the price differentials between the GB market and neighbouring European markets."*

It is unclear to us on what basis Ofgem considers that a further increase of 2.67% would have a material impact on the ability of new entrants to enter the market, and we are surprised that Ofgem appears to be indicating here that a nominal increase in the TO commodity charges (a maximum of 0.00123 p/kwh) would discourage new participants from entering the United Kingdom wholesale market. This is particularly the case having regard to Ofgem's commentary around flowing on an interruptible basis at a 100% discount.

Bacton is the only interconnector point in the NTS where cross-border flows can respond to hub price arbitrages; assuming that, as Ofgem suggests, such users are able to flow on an interruptible, 100% discounted basis, it follows that the contrary position is true and the cost of importing gas via the interconnectors would actually decrease.

To the contrary, our analysis indicates that there is no direct correlation between increases in the TO commodity charge (being a socialised charge across the entire NTS) and wholesale price inflation. This is demonstrated in the chart on the following page, which maps the System Average Price (SAP).

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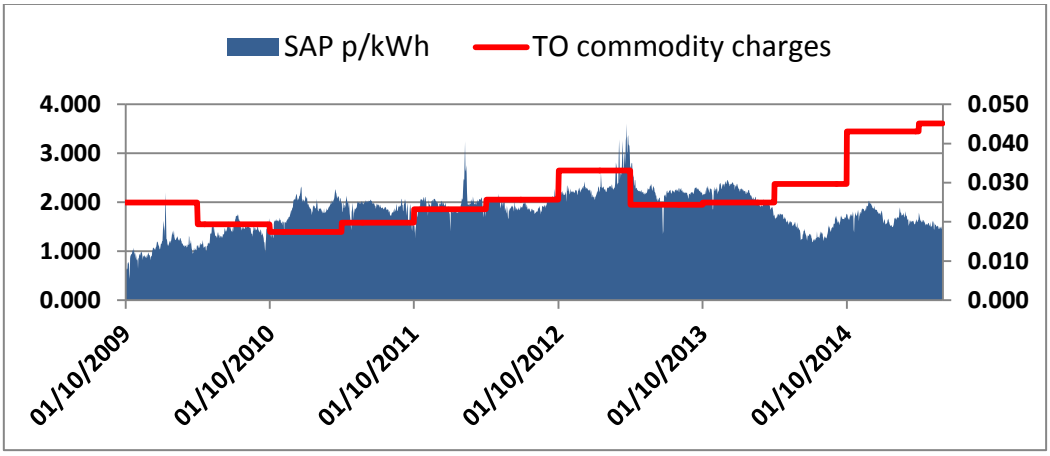
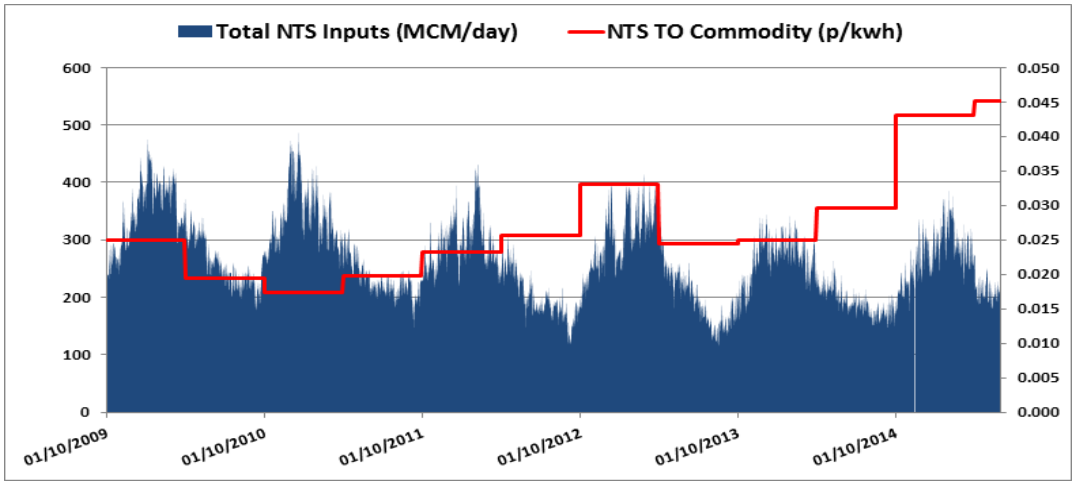


Source: National Grid, System Average Price (for Actual Gas Day) as published on http://www2.nationalgrid.com/uk/industry-information/gas-transmission-operational-data/report-explorer/, Eni interpretation

Moreover, the charts below and on the following page demonstrate that there is no direct correlation between TO commodity charge movements and NTS volumes.



Source: National Grid, Total NTS Input Allocations at all Entry Points as published on http://www2.nationalgrid.com/uk/industry-information/gas-transmission-operational-data/data-item-explorer/, Eni interpretation

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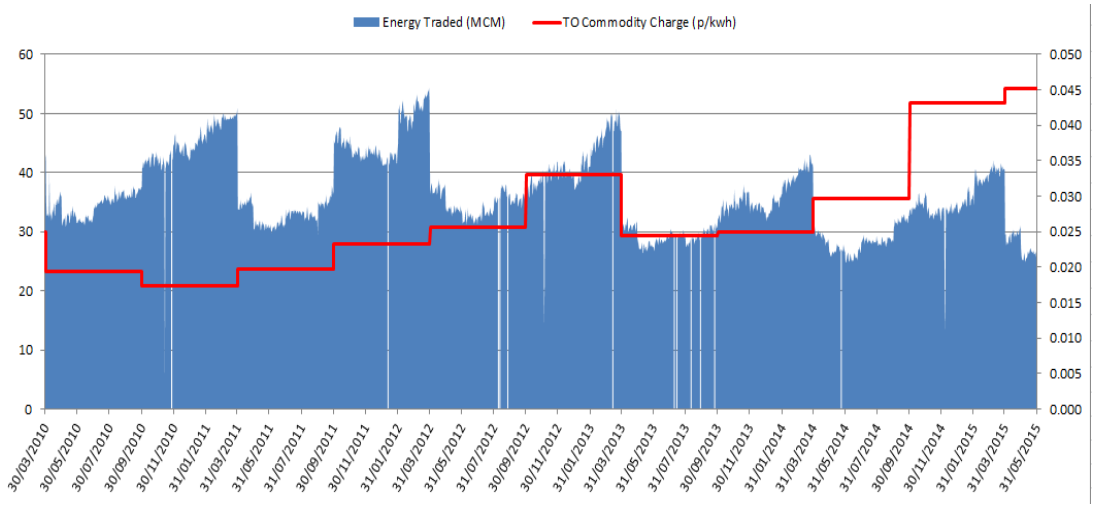

Source: National Grid, On the day Commodity Market (APX) as published on http://www2.nationalgrid.com/uk/industry-information/gas-transmission-operational-data/data-item-explorer/, Eni interpretation

As the above liquidity analysis demonstrates, further quantitative and qualitative modelling of the impacts of the Modification Proposals should urgently be undertaken by Ofgem in order for it to make a cogent decision.

Security of supply

In the Impact Assessment, Ofgem comments on security of supply issues as follows:

> *UNC0501CV may provide some benefit by allowing shippers to use their capacity to bring gas into GB from another route in the event of an outage on one of the interconnectors or domestic field. We do not however have any evidence to quantify this benefit as it will be dependent on the particular situation, capacity holding and shipper's commercial drivers at the time.*
>
> *In addition, as noted above, this aspect of UNC0501CV is not intrinsic to the modification and could be achieved by other means.*
>
> *Conversely, we think that UNC0501V, UNC0501AV and UNC0501BV may be negative in their impact on security of supply as they do not maintain the current level of flexibility. However we think this impact is marginal as capacity can be made available at either entry point through the release of interruptible capacity or the use of anti-hoarding mechanisms such as those envisaged by UNC0500.*

Flexibility as to source of gas is a key component of the current capacity product at Bacton. It is overly simplistic to assert that flexibility represents marginal benefit for existing capacity holders.

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There are significant principles to be protected here which go to the very essence of the efficient and effective operation of the wholesale gas market in the United Kingdom, such as ensuring that confidence in the market is not undermined by substantive regulatory goalpost shifts without appropriate mitigations being adopted. Ofgem has provided no indication that it has properly considered these broader factors. We believe that the regulatory shifts and interference in contractual rights acts as a significant deterrent to long-term capacity booking, which will inevitably affect security of supply in the future. Ofgem itself says that it expects long-term capacity bookings to be replaced with short-term capacity bookings.

Furthermore, we note that the most recent view with respect to the Tariff Code review (following negotiations between the EU Commission, ACER and ENTSO-G) is that contractual pricing rights struck prior to November 2013 should be "grandfathered"[2]. Such a principle recognises the significant potential for commercial damage to ensue from the retrospective revocation of existing contractual rights. We do not regard the circumstances to be any different here; in order for Ofgem to comply with its statutory duties, including the Relevant Objectives, our view is that Ofgem must mitigate the adverse consequences of the Bacton Split on existing capacity holders by adopting appropriate modifications to the UNC.

Modification 0501CV

We note Ofgem makes the following salient comment on Modification 0501CV:

> *"UNC0501CV, if implemented, will create two classes of capacity holder at Bacton. These are Residual Capacity holders (capacity bought pre 1 November 2015 for use in the future), and non Residual Capacity holders (capacity bought after 1 November 2015). Residual Capacity holders will be able to use their capacity interchangeably between the two entry points without incurring an overrun charge (assuming their flows remain equal or below their aggregate capacity holding across the two entry points).*
>
> *We have considered whether this creates the situation where different capacity holders are treated differently and whether this is justified. We consider that UNC0501CV seeks to maintain arrangements that existed when the capacity was originally purchased. Shippers booking capacity after 1 November 2015 are also aware of the product being purchased at that time. We think therefore that while there is an argument that UNC0501CV creates a new class of capacity holder, we do not think shippers booking capacity after 1 November 2015 are being unfairly discriminated against by this change. As a result we do not consider that there will be a negative impact on competition between Residual Capacity holders and non Residual Capacity holders."*

[2] http://www.gasgovernance.co.uk/sites/default/files/Tx%20WG%20June%202015_TarInc%20v1.1.pdf

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We agree with Ofgem's comments here; Modification 0501CV is not enlarging existing long-term capacity holders' rights in any way – the sole purpose of the Modification is to replicate existing rights in the new fundamentally changed Bacton capacity environment.

However, we disagree with Ofgem's characterisation of the rebate regime:

> *"UNC501CV allows a shipper that has bought more bundled Bacton IP capacity than it needed to flow gas or avoid overrun charges to receive a rebate on entry capacity charges when its capacity at both of the two new Bacton entry points was not used to flow gas nor avoid incurring overrun charges at the other new Bacton entry point. The rationale for this was to avoid the situation in a fully bundled world where a shipper has residual Bacton UKCS capacity (resulting from the reassignment process under UNC501CV) but at the time of use wants to flow via one of the interconnectors (i.e. Bacton IP) when unbundled interconnector capacity is not offered. Such a shipper may need to buy bundled Bacton IP capacity (with the corresponding interconnector capacity). As a result the shipper may have to buy double the amount of entry capacity at the two new Bacton entry points than it needs.*
>
> *Under UNC501CV, if the shipper in the scenario in the previous paragraph buys bundled Bacton IP capacity it has the option of flowing both at Bacton UKCS and Bacton IP. If it does not fully use the capacity to flow or avoid overrun charges it gets rebated (for the capacity that was not used to flow or to avoid overrun charges). This would appear to give such existing Bacton shippers a competitive advantage over other users in that they have an optionality of using capacity and if they do not use it they get their money back. This type of arrangement would be contrary to the principle in the capacity regime of "ticket to ride" where shippers are responsible for buying the capacity they need and for them to manage the risk of buying more or less capacity than they need."*

Following the implementation of CAM, it is envisaged that interconnector capacity will be sold predominantly on a bundled basis. Modification 0501CV "grandfathers" flexibility for existing capacity holders by taking account of a user's capacity entitlements across both the Bacton UKCS and the Bacton IP ASEP in calculating whether or not that user is liable for System Entry Overrun Charges.

A practical issue arises where a user wishes to use its capacity entitlement registered to the Bacton UKCS ASEP to flow through the Bacton IP ASEP insofar as it may, in a 'bundled world', need to buy an additional bundled interconnector product in order to flow – for example, where there is no unbundled interconnector capacity available in the market. The purpose of the rebate is to ensure that the user is not forced to pay the NTS Entry Charge twice in order to use the *same* underlying capacity. The existing capacity holder's position is not enlarged – the effect of the rebate is to put the user back into the same position.

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We cannot see how the rebate runs contrary to the "ticket to ride" principle – existing long-term capacity holders have already purchased a ticket to ride.

We note Ofgem's comments regarding the costs of implementing the Modification Proposals:

> *"We understand that the return and or reassignment processes described by the four modifications will be carried out as a paper exercise and managed by NGG. The costs associated with this, and therefore the impacts on existing and future consumers, are not considered to be material. We therefore think that no modification is better or worse than another in this respect.*
>
> *UNC0501CV proposes an additional aggregate overrun plus rebate mechanism which should be implemented and available to shippers from 1 November 2015.*
>
> *In the UNC0501CV Workgroup NGG provided a Rough Order of Magnitude (ROM) that indicated an interim offline solution was required for the aggregate overrun and rebate mechanism until a system solution could be implemented by April 2016 at the earliest. The ROM stated that the interim solution would cost at least £20,000 per annum but probably no more than £50,000 per annum. The enduring solution would cost at least £415,000 but probably no more than £490,000 with unspecified ongoing annual application support costs. While there was debate during the Workgroup on how these costs should be recovered, the proposer of UNC0501CV believed that the modification was a Non User Pays modification (that is, the costs associated would be met by NGG and, depending on whether it warranted a reassessment of allowed revenue, recovered through gas transportation charges). NGG stated during development that they considered the modification to be User Pays (that is, the costs are met by those parties who benefit). Our view is that ultimately these could be met by consumers regardless of the cost recovery method (either by socialisation of gas transportation charges, or via User Pays charges to those shippers who will benefit from the service)."*

Quite simply, the costs of implementing Modification 0501CV are not material; the Authority should not be dissuaded from implementing the Modification on this basis given the significant value and flexibility destruction likely to be suffered by existing capacity holders in the event that Modification 0501V or 0501BV is selected.

4. Conclusion

As stated above, it is incumbent on the Authority, acting consistently with the Relevant Objectives and its statutory and public law duties, to make modifications to the UNC that adequately address the adverse effects of the Bacton Split (which is a unique case in Europe) on existing capacity holders at Bacton.

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In order to perform that task adequately, it is essential that Ofgem properly assesses the impact of the different modifications, taking into account all relevant factors. The impact on competition is particularly important in this context.

It is also essential that Ofgem explains to consultees the reasoning behind its conclusions, such that those conclusions can be properly understood, evaluated and responded to.

In our view, the Impact Assessment falls materially short of the standard required for Ofgem to make a cogent assessment of the various Modification Proposals or for consultees to respond to the Impact Assessment in any meaningful way. We respectfully suggest, therefore, that the Authority stays its decision on the Modification Proposals so as to enable it to properly undertake this critical analysis.