

Halite Energy – Ofgem Fleetwood Entry Point Consultation

Consultation Response

1 INTRODUCTION

1.1 Halite Energy Limited (**Halite**) is a gas storage capacity developer. On 17 July 2015, Halite was granted a Development Consent Order (**DCO**) for the development of a Gas Storage Facility at Preesall in Lancashire (**Preesall Project**).

1.2 Halite refers to Ofgem's recent consultation and proposed decision in respect of the Fleetwood entry point in gas transmission (**Consultation**). Ofgem has set out three alternative options for addressing the perceived problem of capacity and funding for the Fleetwood entry point (the entry point for the Preesall gas storage facility). Halite thanks Ofgem for the opportunity to respond to the Consultation.¹

2 EXECUTIVE SUMMARY OF HALITE'S RESPONSE

2.1 Halite opposes Ofgem's proposed decision. Ofgem has indicated that the question is "finely balanced". However, Ofgem has not taken into account salient factors relevant to any decision in relation to the Fleetwood capacity. Ofgem's Impact Assessment is, in Halite's view, insufficiently developed or robust. Further, there is a very real downside risk to Ofgem's proposals, which has not been adequately considered in reaching Ofgem's proposed decision. In particular:

- (a) The Consultation states that "*no expenditure is forecast for the remainder of the current price control period.*" This is incorrect. Halite is developing the Preesall Project in reliance on the existence of baseline capacity at Fleetwood, and is working towards commissioning Preesall in 2020, necessitating further expenditure during this price control period.
- (b) Ofgem's preferred Option 2 is predicated on delivering a notional financial-benefit to consumers from 2018 onwards. There is no detailed consideration of the *comparative benefit* of returning funding to consumers mid-period, as against Ofgem's normal practice of truing-up funding vs. spending at the end of the period. Given the downside implications of Ofgem's preferred option, inadequate consideration of the comparative benefit is troubling.
- (c) Consequently, Ofgem has taken a narrow view of its statutory duty to protect the consumer interest. There is little or no adequate consideration of the consumer interest in security of supply, reduction of greenhouse gas emissions, and regulatory certainty – all of which would be undermined by Ofgem's preferred option. Security of supply and regulatory certainty are especially critical at this point, given the uncertainties caused by Brexit.

2.2 Halite considers, therefore, that to proceed with Option 2 without either further consideration of these additional factors would be plainly wrong. Once the factors above are taken into account, the balance of convenience is tipped heavily in favour of retaining the status quo (Option 1). Alternatively should Ofgem feel compelled to proceed with one of the other Options, Halite would not object to the reforms as set out in funding Option 3 or capacity Option 3.

¹ Halite notes for completeness that its response to this Consultation is consistent with Halite's previous communications with Ofgem.

3 IMPORTANCE OF STABILITY IN REGULATORY FRAMEWORK

- 3.1 Once an obligation to provide entry capacity exists, *any user* can take advantage of that capacity and make investment decisions on the basis of the obligations and rights associated with that capacity. The regulatory framework provides a clear and transparent model for shippers seeking to acquire entry capacity into the NTS, thereby facilitating efficient investment in downstream markets. The long-term nature of investment planning relies also on NGGT's 10 year statement, which in turn reflects current capacity obligations to which NGGT is subject.
- 3.2 Large scale, long term projects and investments rely on certainty to assess viability and attract investors. This was one of the reasons that, under RIIO, network price limits were to be set for 8 years with only limited re-openers.
- 3.3 The removal of capacity obligations at Fleetwood would cause significant regulatory uncertainty with limited consumer benefits. Indeed, Halite considers that there are no benefits associated with the removal of the capacity obligation and limited benefits from the removal of funding. In 2011 Centrica Energy sought an Income Adjusting Event (**IAE**), to allow Ofgem to take a portion of the benefit that NGGT may have received as a result of its decision not to continue investment to increase Fleetwood entry capacity. In December 2011 Ofgem decided that an IAE had not occurred. Ofgem stated clearly to Centrica the need for regulatory certainty:

"However, the current gas transmission entry regime was not designed with such a situation in mind. Ofgem has always recognised the importance of regulatory certainty and the benefits this brings to both licensees and consumers. The special licence conditions in the NTS licence put in place at the price control review were the subject of consultation with the industry and were accepted by NGG and Ofgem as part of the price control package. No one anticipated the Fleetwood situation arising. Seeking to make licence modifications to remove NGG's obligation to provide capacity at Fleetwood without the consent of the parties concerned could be considered to be undermining the regulatory regime, which would ultimately be to the detriment of consumers. NGG has indicated that it wishes to keep the obligation to provided capacity at Fleetwood. This means that the capacity will ultimately become available to other shippers through the entry regime by capacity substitution, trade and transfer". (para 5 of Ofgem Letter Fleetwood Entry Point: Income Adjusting Event for National Grid Gas NTS dated 6 May 2011).

- 3.4 Ofgem reiterated this point in the Consultation document.²
- 3.5 Any decision to remove committed capacity midway through a regulatory period (as opposed to increasing that capacity) would be unprecedented.³ Ofgem has previously recognised the importance of stability in reviewing base line capacity:

² "We are also mindful of the need to maintain a stable and predictable regulatory environment for users of the NTS. We have never previously removed capacity obligations in their entirety at an entry point. We have also previously said that seeking to remove the capacity obligation at Fleetwood without the consent of the parties involved could be seen as undermining the regulatory regime and be detrimental to consumers." (Consultation paras. 2.19 – 2.20).

³ Halite notes that in March 2007, Ofgem reviewed baseline levels of entry capacity for the NTS as part of the 2007-2012 Transmission Price Control Review. The baselines were subject to further review in 2008, following issues caused by significant reductions of baseline capacity at entry points that were below the forecast maximum flows. The review resulted in a slight increase in the overall baseline levels, as well as addressing issues which had arisen due to miscalculations at certain entry points.

- (a) *"We consider that it is important that network companies, gas shippers and gas suppliers have confidence in the regulatory regime given the long lived nature of investment in pipelines and most gas infrastructure."* (para. 2.9, Ofgem's final decision in TPCR Gas Entry Baseline Review, 20 May 2008).
- (b) *"We believe that both the re-consultation process and addressing the unintended consequence of the TPCR baseline methodology will to the maximum extent possible maintain regulatory certainty and regulatory predictability. We also think that this will best protect consumers' interests because shippers and/or developers who are confident in the UK regulatory regime will be more willing to invest in the UK."* (paragraph 2.11 of Ofgem's final decision in its baseline review).
- (c) *"In our view, making significant changes to a price control (as would be the case under options 2 and 2a) so soon after it was agreed without significant new information or other compelling reasons could damage investor confidence and hence could actually reduce regulatory certainty and regulatory predictability."* (paragraph 2.13 of Ofgem's final decision in its baseline review).

3.6 As regarding its approach to future baseline reviews, Ofgem was clear that *"there would have to be strong and compelling reasons"*, such as new significant information, to re-open a price control.⁴

3.7 Ofgem's proposals will send clear signals to all investors, developers and users, about the credibility of the regulatory regime. The long-term investment horizon in this sector means that investors place great weight on predictability. Investors have invested substantial sums based on a regulatory framework, and a mid-period removal of capacity at Fleetwood risks chilling investment decisions throughout the whole network. This would have material negative impacts on users, investors, and customers.

4 **CONSULTATION AND IMPACT ASSESSMENT DO NOT ADEQUATELY WEIGH SEVERAL MATERIAL FACTORS**

4.1 The Consultation and Impact Assessment do not adequately consider a number of salient factors in reaching the proposed decision. This undermines the credibility of the proposals set out in the Consultation. Each element is explored further below.

4.2 **There is a live project**

4.2.1 First, as noted in Section 1 above, Halite is developing the Preesall Project in reliance on the existence of baseline capacity at Fleetwood, and is working towards commissioning Preesall in 2020. NGGT is fully aware of Halite's plans and proposed timings. All such information is consistent with Halite's previous

⁴ Ofgem has been clear that reviews of baseline capacity should be limited to circumstances where there is significant new information. Halite does not consider that Ofgem has received any significant new information regarding Fleetwood. In 2010, following Canatxx's failure to meet its financial obligations under its user commitment, Ofgem considered modifications to the UNC, proposed by NGGT (UNC Modification 246). The proposals sought to address concerns associated with funding of user commitments and the impact of shippers defaulting on funding. Ofgem rejected proposals to amend the UNC. At that stage Ofgem did not seek to take any action to reassess baseline capacity at Fleetwood. Similarly, Ofgem considered NGGT's baseline licence obligations during its RIIO-T1 price control review in December 2012. Halite acknowledges that in its determination Ofgem noted that it was monitoring the situation at Fleetwood. Ofgem stated that "should circumstances require" it might take action to protect the interest of consumers. Halite considers that there has been no significant change in circumstances since that determination. Rather, there has been a clear expression of demand at Fleetwood through the sale of capacity through the auction process.

correspondence with Ofgem. Further, as Ofgem recognises in the Consultation, forward capacity has indeed been purchased at Fleetwood.

4.2.2 It is clear, therefore, that there is a consented development at the Fleetwood Aggregate System Entry Point (**ASEP**) which will (when completed) require access to the baseline capacity at that ASEP. The anticipated development timeline of the Preesall Project will require further expenditure in respect of the Fleetwood ASEP during this price control period. It is therefore not correct to state that “*no expenditure is forecast for the remainder of the current price control period.*”

4.3 **Ofgem’s consideration of its statutory duties is incomplete**

4.3.1 Ofgem’s principal objective is to protect the interests of existing and future consumers. The interests of those consumers are their interests taken as a whole, including their interests in reducing greenhouse gases and security of supply.

4.3.2 Ofgem’s proposals have been based on the expected financial savings that would be achieved by removing the funding associated with the existing capacity obligation. The Consultation notes that such removal would reduce consumer costs as NGGT would no longer need to be funded to maintain the relevant obligations.

4.3.3 However, as set out in this response, the limited benefit which the removal of funding costs would have to consumers, is outweighed by the longer-term harm to consumers which would flow from any decision to proceed with Ofgem’s proposals and the adverse impact on cost of capital caused by a fundamental overturning of a key element of gas regime regulatory stability – the baselines.

4.3.4 Consequently, there is a significant risk that Ofgem’s proposal, if confirmed, would not reflect appropriately the relevant statutory duties to which Ofgem must have regard. In particular:

(a) Narrow interpretation of “consumer interest”

4.3.5 Ofgem’s decision appears to be predicated exclusively on existing consumers’ financial (cash saving) interests. Future interests – in lower-cost, and less volatile gas pricing, and more secure (and predictable gas flows) – do not appear to have been expressly considered.

4.3.6 Indeed, the proposed decision appears to favour the narrower interests of existing consumers in achieving relatively small levels of cash savings over the remainder of the RIIO-T1 price control period, where the relative scale of such savings is small:

(a) Total cash benefit for the remaining 3 years of the current period is not £277.5m, it is the cost of funding (i.e. National Grid WACC of 4.38%).

(b) When weighed against the negative effects of the proposals outlined, the narrow cash saving is minimal (c.£36m).

(c) Further, the cash saving Ofgem calculates is a notional saving of only 60p a year per consumer, when averaged on a per household-basis.

4.3.7 There is no detailed consideration of the *comparative benefit* of returning funding to consumers mid-period, as against Ofgem’s normal practice of truing-up funding vs. spending at the end of the period.

- 4.3.8 As a result, there is no consideration of Ofgem’s broader statutory duties under section 4AA(1A) of the Gas Act 1986, including in respect of (a) security of supply; and (b) greenhouse gas emissions.
- 4.3.9 Moreover, consumers have a legitimate interest in the robustness of the UK energy regulatory framework. Ofgem’s proposal – taken in the context of additional uncertainty resulting from Brexit, economic headwinds, and the proposed energy retail price cap – risks undermining the credibility of the UK framework.
- 4.3.10 For the reasons set out in section 3 above, certainty about the rights to access capacity at points throughout the NTS is ultimately highly beneficial. It provides long-term signals for efficient investment in downstream energy projects. Shippers can be confident that the baseline capacity which NGGT is required to make available in accordance with its Licence is treated as a capacity “floor”, against which investment decisions can be made. Removal of existing baseline capacity obligations is contrary to Ofgem’s previous approach.
- 4.3.11 Therefore, removal of the capacity obligation at Fleetwood risks undermining investment incentives throughout the entire NTS. The current climate of political and regulatory uncertainty resulting from Brexit and the Government’s potential retail price cap has further dampened investor appetite, and increased both debt and equity costs for major investments. Such conditions undermine the viability of marginal – and potentially even non-marginal – investments anywhere in the NTS, irrespective of location.

(b) Security of supply

- 4.3.12 The Preesall Project will create a large-scale gas storage facility which will comprise approximately 20% of total UK storage deliverability.⁵ This Short Range Storage will be a major piece of critical infrastructure that will make a telling contribution to the UK security of supply position.⁶ Should Ofgem proceed with its preferred option, the future position of Preesall will inevitably be reconsidered. Any such outcome would clearly be detrimental to the consumer interest.
- 4.3.13 Security of supply in energy markets is rightly recognised as critically important to the ongoing economic and social strength of the UK. There are numerous statements, reports and papers which clarify this point expressly. For example:
- (a) Ofgem has noted that *“increased exposure to international gas markets has...increased the range and likelihood of possible sources of disruption, including certain shocks that could have profound impacts on GB security of supply”*. Continuing, Ofgem noted that *“...looking forward, there is likely to be an increase in the need for flexibility from our gas supplies. This is to meet larger and faster swings in demand from gas-fired electricity generators as their role in balancing the intermittent output of a growing quantity of installed renewable generation increases.”*

⁵ 27% additional deliverability for all UK salt cavern storage and an additional 21% for all UK storage deliverability

⁶ Preesall’s Short-Range Storage has shorter injection and withdrawal times than the Rough Storage facility. It would be able to react more quickly to demand fluctuations, injecting when gas demand or prices are lower, and withdrawing when higher. As intermittency in the generational mix increases, reliance on a robust short range storage facility to balance supply and demand will be vital. Indeed, National Grid’s 2016 Ten Year Statement sets out a range of energy scenarios, of which the “Gone Green” and “Slow Progression” scenarios both require flexible storage facilities. Short Range Storage, which provides short notice flexibility required to cover wind intermittency, fits the future needs of the gas market better than long range storage.

- (b) The House Energy and Climate Change Committee has also stated that *"The UK needs more gas storage capacity capable of delivering gas at a high rate. The Department of Energy and Climate Change should be concerned about the lack of gas storage used to manage seasonal demand fluctuations. It should aim to double the UK's current gas storage from current levels by 2020 in order to avoid exposure to gas supply interruptions and price spikes, and, in the longer term, to ensure a resilient gas supply to flexible gas plants acting as "backup" to intermittent electricity generated from wind."* (para 77).

4.3.14 Reduced security of supply in the form of limited storage capacity will only serve to increase the cost to consumers. Indeed, recent developments in relation to the Rough storage facility have resulted in the closure to new gas injections until April 2018, and the future viability of Rough is in question. This change of circumstance since Ofgem published the Consultation means that the UK faces even more difficulties in securing credible storage capacity to meet future consumer demand.

4.3.15 It would therefore appear difficult to reconcile any decision to proceed with Ofgem's preferred approach with Ofgem's primary duty to have regard to the interests of current and future consumers in respect of either security of supply, or maintaining low and predictable wholesale gas pricing.

(c) Reduction in greenhouse gas emissions

4.3.16 The reduction of greenhouse gas emissions is an important policy consideration which Ofgem's Consultation and Impact Assessment does not adequately consider. In addition to improving security of supply, the development of fast cycle storage supports the reduction of greenhouse gas emissions.⁷

4.3.17 The importance of increased use of gas to reduce greenhouse gas emissions was recognised by NGGT in its RIIO-T1 Business Plan Overview (March 2012).⁸

(d) Promotion of competition

4.3.18 Section 4AA(1B) of the Gas Act 1986 requires that Ofgem, in carrying out its functions in accordance with the principal objective to protect the interests of existing and future consumers, promotes competition wherever appropriate.

4.3.19 Halite notes Ofgem's position that removal of the baseline capacity at Fleetwood would create a more level playing field as between users and different ASEPs throughout the NTS. In particular, the User Commitment principle would continue to apply, such that any user could apply for additional (non-baseline) capacity if they can meet the Net Present Value test and enter into a User Commitment for the required capacity.

⁷ This type of gas storage reduces emissions by: efficient space heating; accelerating the replacement of coal as an intermediate source of low carbon energy; and supporting the intermittency of renewable energy by rapid reaction gas generation.

⁸ In that overview NGGT noted: *"The path to low-carbon energy is driven by UK Government and European targets for emissions and renewable energy, which will ultimately deliver an 80% cut in greenhouse gas emissions, compared with 1990 levels, by 2050. Meeting these targets will require the UK to reduce emissions from electricity generation through increased deployment of renewable and other low-carbon power generation. Our business plan reflects the resulting impact these changes will have on the gas transmission network. The utilisation of gas will remain an efficient approach to space heating, particularly during winter peak demand, and the use of gas red power stations will provide an economic way to help balance the variability introduced onto the electricity network by wind generation."*

- 4.3.20 Ofgem appears to consider, therefore, that removing the baseline capacity at Fleetwood would have a neutral to positive effect on competition throughout the NTS.
- 4.3.21 Halite disagrees with this assessment. At present, the existence of the baseline capacity at Fleetwood provides an opportunity for innovative new entry to enhance security of supply. Any user – whether existing or de novo entrant – can take advantage of the capacity obligation to achieve entry at Fleetwood. In the case of the Preesall Project, retention of the capacity obligation is expected to enable it to provide downward pricing pressure on wholesale gas prices in Great Britain, through the release of storage gas at peak periods.
- 4.3.22 In practice, therefore, the removal of the capacity obligation would have a detrimental effect on competition and downstream prices. Customers would be the ultimate losers in this scenario.

5 OPTIONS 1 AND 3 ARE NOT ADEQUATELY CONSIDERED

- 5.1.1 The Consultation and Impact Assessment do not provide a detailed assessment of the relative merits of either Option 1, or Option 3 (with regard to either funding or capacity). This limits the robustness of the preferred option identified by Ofgem.

(a) No discrimination in either Option 1 or Option 3 (both funding and capacity)

- 5.1.2 Ofgem has expressed concern that choosing either Option 1 or Option 3 (reducing capacity to 350GWh) may be discriminatory.⁹
- 5.1.3 The Consultation suggests that Fleetwood is a unique situation because of the collapse of the Canatxx user commitment. This is incorrect. The user commitment provides a guarantee that the amount of capacity which has been committed will be available for the sole benefit of that user. No single user benefits from the lapsed Canatxx commitment. All prospective users at Fleetwood have the ability to bid for some or all of the 650GWh baseline capacity via the auction process. This principle would apply (in proportion) in the event that Ofgem selected Option 3, and reduced the capacity obligation to 350GWh.
- 5.1.4 As noted elsewhere, the existence of the vacant user commitment has lowered barriers to entry for the benefit of all users. Given that capacity can be substituted and transferred throughout the NTS, committed baseline capacity at one ASEP provides clear signals to all investors and users as to the total available capacity in the system. Therefore, no single user (including Halite) is uniquely placed.
- 5.1.5 Additionally, the availability of excess baseline capacity is not unique. Indeed, we understand that there are numerous examples of existing baseline capacity underpinning investment decisions, including Bacton (which underpinned investment in the BBL interconnector), Easington,¹⁰ Teesside¹¹ and St Fergus.¹²

⁹ Discrimination in this context is understood to amount to the application of dissimilar conditions to equivalent transactions or situations, thereby placing one party at a competitive disadvantage (see, for example, Ofgem Notice of Decision to Accept Binding Commitments from SSE plc., 3 November 2016).

¹⁰ The purchase of existing baseline capacity at Easington by Langed gas shippers (for which no specific user commitment was required) meant that existing Easington shippers no longer had access to the unsold baseline capacity (as they had not chosen to buy ahead such capacity).

¹¹ An investment of £40 million by Exceleerate into the GasPort facility on the basis of existing baseline capacity at Teesside. In this case issues arose when, as part of its review of baselines associated with the price control process, Ofgem sought to reduce baseline capacity in Teesside in 2007. Exceleerate was negatively impacted

(b) Either Option 1 or Option 3 (Funding or Capacity) would be more proportionate

- 5.2 Given the importance of regulatory certainty for investment decisions throughout the NTS, Option 1 is appropriate and should have been given greater consideration in the Consultation. Indeed, as noted above, the current situation has lowered barriers to entry, and innovative entrants are able to deliver efficient (and ultimately cheaper) projects in the Fleetwood ASEP in part because of the current NGGT capacity obligation. Further, the Preesall Project has relied on the existence of baseline capacity at Fleetwood, and is scheduled for commissioning in 2020.
- 5.3 If additional NGGT investment is not actually required in light of its capacity obligations at Fleetwood, the excess funding will be returned to customers in the next price control. The relative benefit to customers in receiving funding relief from 2018 as compared to funding repayment in 2022 onwards is anticipated to be minimal. However, the benefit to regulatory certainty, innovative new entry and security of supply by retaining the current obligation, would be enormous.
- 5.4 Similarly, Ofgem has outlined a further alternative to total removal of capacity obligations. Funding Option 3 (funding removal but retention of capacity obligation) or capacity Option 3 (reducing the funding and capacity obligations to 350GWh) would both provide a more proportionate alternative to Option 2. Halite considers that whilst any change to capacity would undermine the principles of regulatory certainty, Option 3 is likely to have a less chilling effect on investors than the total removal of capacity under Option 2.
- 5.5 However, Halite wishes to emphasise that any review of entry capacity which is done for a single entry point (as is the case in Option 3) risks generating unintended consequences elsewhere.
- 5.6 Furthermore, such a reduction as detailed in Option 3 is highly unlikely to have the effect of distorting competition because any user would be able to bid for the whole or part of the reduced capacity at Fleetwood. This includes existing users and de novo entrants.

6 CONCLUSION

- 6.1 There are clear limitations in the Consultation and Impact Assessment. Consequently, proceeding with Option 2 without further consideration of the additional factors outlined in this response would be inappropriate.
- 6.2 Once the factors above are taken into account, the balance of convenience is tipped heavily in favour of retaining the status quo (Option 1). Alternatively should Ofgem feel compelled to proceed with one of the other Options, Halite would not object to the reforms as set out in funding Option 3 or capacity Option 3.

by this reduction in baseline capacity and in July 2007 sought to judicially review Ofgem's decision. In Excelebrate's statement of case it was noted that both Ofgem and the Department of Trade and Industry had been aware of Excelebrate's intention to rely on available baseline capacity at Teesside. Although the claim settled, Ofgem specifically addressed the issue of baseline capacity at Teesside in 2008.

¹² Baseline capacity at St Fergus has remained in place, despite the associated funding being removed from NGGT (due to the lack of user commitment).