The Gas Forum

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Dear Paul

<u>User Commitment for National Transmission System Quarterly Entry Capacity – Initial Impact Assessment on modification proposals</u>

Thank you for the opportunity to comment on the above Impact Assessment (IA) which has been produced as part of your decision process for UNC modification proposals 0246, 0246A and 0246B.

We believe that most of our members will be responding directly on this document as it is clear that any issues that relate to Credit are likely to be viewed differently by individual companies. The proposals may also have significantly different impacts on companies according to how active they are in the NTS entry capacity market, particularly the long-term auctions.

That said the Gas Forum welcome the work that has gone into the Cost versus Benefit aspects of the Impact Assessment together with its discussion on licence issues that were outside of the remit of the UNC but which might facilitate the same end goal of protecting the consumer from the effects of credit default by a shipper.

Overall the Gas Forum believes that the IA fails to demonstrate that any of the 3 proposals should be implemented taking into account the history over the life time of the UNC and more recently the long term auctions with regard to shipper default for entry capacity bookings. All 3 proposals impose significant additional cost that would generally have to be reflected in prices paid by consumers. In assessing the benefits the IA recognises that there would have to be very significant volumes of capacity default to justify these costs particularly where the main default exposure only relates to incremental capacity where this has been booked but not then utilised.

As such we believe that there are non-UNC alternatives to the modifications that may better address the problem of User default and we are pleased that you have also recognised this regarding the alternatives you have asked for comments on in the IA. There are also cross-overs with the discussions on Entry Capacity charging and the application of different reserve prices and incentives for long term versus short term versus interruptible capacity.

Further it is our view that the overall problem that has triggered discussion is the potential for default by a single shipper having booked incremental capacity at a new System Entry Point as opposed to an existing System Entry Point, specifically the Canatxx capacity at the Fleetwood Entry Point. If it is envisaged that there will be a significant number of these commissioned over the next few years, (for example new storage and/or new small scale gas input), then it may warrant a fuller review of mechanisms for commissioning new capacity, for example the introduction of payments for feasibility/planning studies and/or ARCA-type agreements for such discrete connections.

Comments on the Alternative Approaches

We have commented on the alternatives in line with the overall preference of our members for the proposal, although we also recognise that the alternatives are not exclusively stand-alone options. The Gas Forum also believes that any implemented change should also be capable of addressing the Canatxx situation.

Income Adjusting Event (IAE)

The Gas Forum understands the reluctance of the Authority to create a situation where allowed revenues and costs are subject to frequent adjustment. Gas Forum members themselves have long campaigned for revenue stability to assist in forecasting etc. However where NGG NTS is likely to make a windfall gain without incurring any additional risk, it seems appropriate that a shipper or shippers should be able to request the Authority to adjust the allowed revenue.

Clearly the current Canatxx concerns could be an illustration of this whereby the revenues that NGG NTS stand to collect are totally disproportionate to the costs they have or will incur and with shippers/consumers having to pick up the default. The Gas Forum recognises that the IAE decision will rest with the Authority but would point out that the bulk of any costs passed through to shippers are likely to, at some stage, be reflected in consumer prices.

Revenue Drivers

The introduction of phased release of the revenue stream may be a viable alternative which could reduce the need for IAEs, ensuring that NGG only receive revenues in line with costs that they have incurred. Again, re Canatxx this could recognise that the NGG NTS allowed revenue should only reflect the planning costs that they have incurred as opposed to the full cost of a pipeline that they have not yet delivered. Our concern regarding this approach is that it may only be applicable in limited circumstances, such as where all the capacity is provided though a new pipeline connection to the NTS. Also it may be complex to both obtain the pertinent information and to administer.

Shipper termination

Shipper termination could be considered an alternative measure where the defaulting shipper has not yet started to flow gas. Once gas flows have commenced then the current process should be continued to ensure that both Transporter and other Shipper risks are properly addressed. As you state it may be expected that NGG NTS would approach the Authority on the grounds that it would not be economic and efficient to continue with the current capacity obligation. However it seems unlikely that NGG NTS would be motivated to make this approach bearing in mind that under the current rules they will be eligible to collect the revenue regardless of the default. Thus it may be more realistic if the Authority could receive and consider a request from a shipper to consider termination of the defaulting shipper.

Other

There are still circumstances whereby NGG NTS could provide a significant new investment but shipper default could then occur before the costs can be recovered. If a new input/storage facility has been constructed then it is likely that another party will require the capacity at some stage, albeit later than originally envisaged. Hence partial or full assignment rather than traditional termination may be preferable. One option may be to move the defaulted capacity into an NGG NTS account to facilitate later assignment rather than cancelling out the initial capacity sale. The issue then would be whether on taking the capacity the acquiring shipper(s) pay for the capacity only from the point of acquisition or from the original date that the capacity was requested.

The above alternatives would still leave an exposure whereby shipper default occurs after NGG NTS has completed its full investment. Assuming NGG has exercised all due diligence in deciding to complete the physical connection, this would appear to be a true stranded asset which it would seem reasonable to incorporate into the RAV. Not to do this but refuse NGG NTS the revenue is only likely to justify an increase in the NGG NTS risk which could have a greater overall impact on costs. However it is still not clear why shippers should have to be exposed to these costs as opposed to say the Government, particularly where the investment has been in response to Government signals for new storage/renewable gas.

The Gas Forum is content that this response may be placed on the Ofgem website and in the Ofgem library. We hope you will take these comments in the constructive manner in which they are meant, and look forward to continue to work with Ofgem in the future.

In the meantime if you require any further clarification or wish to discuss our response further please do not hesitate to contact the Gas Forum on 0207 090 1015.

Yours sincerely

Franck Neel

Chairman of the Gas Forum