Representation For. 0037

"Limitation on offering for sale unsold capacity"
Version 1.0

Date of Communication:	25/07/2005
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Slant:	Against
Strictly Confidential:	No

Abstract

0037 Limitation on offering for sale unsold capacity

I refer to the above urgent modification proposal raised by National Grid Transco - UKT. It proposes that Transco NTS's current obligations to offer unsold capacity be limited when certain criteria are met, namely that there is a risk that Transco will be unable to deliver the capacity or that there will be high buy back costs.

Shell Gas Direct (SGD) does not support this proposal. Along with many shippers, we are surprised that this proposal has been raised so close to the expected time of the LTSEC auctions. We must also raise concerns about such a significant proposal being given urgent status with less than a week to comment, particularly over a holiday period. We do not consider this provides a transparent process.

We consider this proposal to contain major changes in approach from that originally implemented for the LTSEC auctions and the incentives on Transco. Transco has been given a number of complex incentives in its price control to encourage it to maximise available capacity and to take on risk when it cannot deliver capacity sold. Transco accepted these incentives but now appears to be responding to them not by making investment or finding other commercial solutions but by changing the arrangements themselves. This is inconsistent with the "commercial" approach envisaged for Transco to take.

SGD notes that when the LT auctions were put in place, Ofgem stated that it expected shippers' exposure to buy back costs to reduce over time. If Transco's concern is shippers' exposures, it would seem sensible to change the sharing factors to reduce these. However, it appears to us that it is more likely that Transco's concern is its own exposure and the effect that this could have on its incentive package.

Transco suggests that an exceptional circumstance could be in the event that shippers "purchase capacity solely on the expectation that they would receive buy back payment". It may be that some shippers have already calculated that this is an efficient approach. We note that Ofgem has stated that it would have no specific regulatory concerns with shippers taking such an approach, and saw benefits with increased liquidity . As Transco knows, it is not the case that if it needs to make significant buy backs that all shippers will face costs equally as those who have sold back the capacity in the first place will have revenue to balance out these costs. Ofgem made clear that shippers would need to ensure that any "speculative" purchases of capacity need to be within competition law, financial services regulations and licence obligations. If Transco has concerns in these areas, they should raise them direct with Ofgem and/or the appropriate regulatory authority.

Overall, the effect through the capacity neutrality arrangements should be neutral and we see no reason to suggest that there would be any effect on end-consumer prices. Transco is not clear about what it means by "inefficient" levels of buy back costs and we can only assume that they have equated "inefficient" with "high". We do not see any justification for this approach. We note that Transco NTS has benefited from the incentive arrangements when it was able to sell capacity without additional investment: it would appear that when it has a potential financial exposure, Transco's approach differs. Any other concern about "inefficiency" should be raised with Ofgem direct in respect of baseline levels or other areas of concern. By accepting the licence conditions, we consider that Transco has accepted a package which it should not be attempting to change through the UNC route.

If Transco has significant concerns regarding the LTSEC auctions, buy back arrangements and associated incentives, it should have brought these to the attention of the industry before raising urgent proposals. We do not consider the UNC route to be the most appropriate route for resolution of these issues. We are not convinced that this proposal is consistent with Transco NTS's licence obligations to release any unsold entry capacity to the market.

SGD does not support this proposal. We cannot concur with Transco's assertion that avoiding potentially high buy back costs is consistent with efficiency. We consider that the major changes proposed here undermine effective competition between shippers and therefore do not further the relevant objectives of the UNC.

In SGD's response to Ofgem's recent consultation on UCAs, we recommended that a full, independent review of the LT auction arrangements should be carried out. Auction processes for pipeline capacity will always be difficult: one of the criticisms of the previous approach with 6 month auctions was that there were too many urgent proposals before each round. This proposal, along with urgent proposal 0036, reinforces our view that an auction-based regime contains a high degree of regulatory uncertainty and that a simpler approach may provide better outcomes for the industry and, ultimately, for gas consumers.

Yours sincerely

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