Modification Proposals 246, 246A,246B – Quarterly NTS Entry Capacity User Commitment
Comments from AEP[1]

The Association welcomes the opportunity to comment on the draft modification report and alternative proposals that have subsequently been raised. The Association supports 246B since we believe this delivers an improvement to the current arrangements at a reasonable cost to customers and is a proportionate response to the issues identified without retrospective application. However we believe Ofgem must undertake a regulatory impact assessment of all options including possible licence changes to satisfy itself and demonstrate to the industry that the cost burden to customers is justified and proportionate to the risks identified. Clearly the impact assessment should consider which credit tools are cost effective and whether all capacity bookings should be securitized or only new bookings.

We have been asked to provide a ranking of proposals; we favour 246B followed by 246A. We do not support 246.

All the proposals address two issues; 1) where a shipper has committed to Quarterly System Entry Capacity through long term auctions yet insufficient credit is put in place the ability to defer capacity delivery at no cost to themselves. 2) The gap in time between making a commitment to capacity and the need to demonstrate a financial commitment to this capacity.

The approach to issue 1) is consistent across all proposals and we support this since it is an improvement on the current arrangements. However we consider a better solution would be to address this through the transporter licence so that in circumstances where the capacity is no longer needed as a project does not go ahead and where NG has not invested to provide the signaled capacity, auction revenues do not feed into the allowed revenue. This would avoid these auction revenues being reflected in transportation charges paid by shippers and ultimately customers.

It may also be possible to approach the issue of project risk differently by learning from the exit regime where the adhoc process provides for a

[1] The Association of Electricity Producers (AEP) represents large, medium and small companies accounting for more than 95 per cent of the UK generating capacity, together with a number of businesses that provide equipment and services to the generating industry. Between them, the members embrace all of the generating technologies used commercially in the UK, from coal, gas and nuclear power, to a wide range of renewable energies.

demonstration date and demonstration information to be provided prior to significant capital expenditure and cancellation or delay of capacity bookings in a controlled manner if the relevant information cannot be provided. This helps to efficiently manage the projects of both the developer and National Grid, within the constraints of the commercial regime and at new ASEPs could be linked to auction revenues flowing into allowed revenue.

The approach to issue 2) varies across the proposals in respect of what tools are available to securitise booked capacity and whether this applies prospectively to new bookings or retrospectively to existing bookings. In this respect we feel it is important to balance the risk of company failure and project failure against the probability of these events and the potential cost to customers. Proposal 246 appears to suggest that there is £20M p.a. at risk, yet only 10% (or £2M) of this would be covered by the security needed in this proposal, whereas the cost of providing security for 10% of allocated capacity values across all Users is estimated to be £4M p.a. It is expected that this cost would be passed onto customers therefore it is difficult to understand how this is a proportionate solution to the issues and risks identified, even if there are other un-quantified benefits. We therefore do not support proposal 246.

The annual cost of the alternative proposals is expected to be less since other, less costly tools, would be acceptable for providing security and in the case of 246B only future QSEC bids are considered. We would expect a regulatory impact assessment to assess these issues in more detail. Our initial view is that other transportation credit tools should provide acceptable security as they do in other parts of the UNC and provide a more cost effective means of addressing the risks identified, We also consider that the proposal should only apply to future QSEC bookings since to apply this to bookings made retrospectively only enhances the perceived regulatory risk and uncertainty of making investments in the UK gas industry at a time when such investments should be encouraged. Changing the commercial framework after bidding strategies have been decisions have been determined and long term commitments made is rarely appropriate. To apply to retrospective bookings would also appear at odds with the justification of the proposal in term of how it furthers the relevant objectives primarily by reducing speculative bidding which is clearly a prospective activity.

The Association would also like to note some process concerns. At first sight proposal 246 appeared to have been raised following the work of review Group 221. However it was only on closer scrutiny that it became apparent that this proposal does not reflect the outcome of the Review Group nor has that group agreed and issued its final report to the Panel. Whilst the Association has not been involved in this Review Group we are aware that there have been extensive discussions on these issues and find it difficult to assess this proposal in the absence of the Review Group report.

We consider that the proposal furthers the relevant objectives;

SSC A11.1 (a) efficient and economic operation – its not clear to what extent speculative bidding for entry capacity is a problem but this should be reduced under all proposals equally given the requirement to lodge security prior to bidding. This inturn should give greater confidence in system developments.

SSC A11.1 (c) efficient discharge of licencee's obligations -
Requiring users to provide security for potential holdings in advance of the allocation process reduces speculative bidding which could influence the outcome of an auction and reduces the potential for NG to provide unnecessary physical NTS entry capacity.

SSC A11.1 (d) securing effective competition – all the proposals reduce the cost burden on Users arising from default in a similar manner so this does not impact on competition.

Implications of implementing the Modification Proposal for Consumers.

We would anticipate that the costs of securing credit and the User Pays elements of the implementation costs will the passed through to customers as part of shipper's costs, therefore we expect customers bills to rise.

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