

## Gas Transmission Entry Charging Review

### Meeting Report: 09 September 2009

*This report outlines the key discussions of the first GTECR meeting held at Ofgem Offices, 9 Millbank, London, SW1P 3GE on 9<sup>th</sup> September 2009. Supporting material can be found at [www.nationalgrid.com/uk/Gas/Charges/TCMF](http://www.nationalgrid.com/uk/Gas/Charges/TCMF)*

#### Attendees

Tim Davis (Chair)	TD	Joint Office
Andrew Pearce	APe	BP
Angus Paxton	AP	Poyry Consulting
Brendan O’Riordan	BOR	Bord Gais
Clive Woodland	CW	Centrica
Debra Hawkin	DH	National Grid NTS
Eddie Blackburn	EB	National Grid NTS
Fraser Ashman	FA	Wingas
Guang Yang	GY	Centrica
James Thomson	JT	Ofgem
Jemma Spencer	JS	National Grid NTS
John Baldwin	JBa	CNG Services
John Bradley	JBr	Joint Office
Justin Jackson	JJ	ExxonMobil
Mark Dalton	MD	BG Group
Mary Simmons	MS	Interconnector (UK)
Nick Wye	NW	WatersWye
Richard Fairholme	RF	E.ON
Richard Miller	RiM	Ofgem
Roddy Monroe	RoM	Centrica Storage
Sofia Fernandez Avendano	SFA	Total
Stefan Leedham	SL	EDF Energy

#### 1. Introduction

TD welcomed attendees to the meeting.

#### 2. Terms of Reference

The Terms of Reference were introduced by EB. RiM suggested incorporating a number of issues raised by Ofgem in decision letters following recent pricing consultations. These were:

- GCM06 – the treatment of spare capacity in the Transportation Model. (EB suggested that the calculation of entry prices using forecast flows rather than obligated levels could be revisited);
- GCM16 - supply and demand balancing rules and supply source data;
- GCM12 - retrospective negative TO commodity charges - whilst acknowledging that the main thrust is on under-recovery at present, RiM suggested over-recovery treatment should be within the Review’s scope.

In addition, RiM suggested there may be lessons to be learnt from recent experience in the electricity industry.

MD added that lessons from elsewhere in Europe were also worth considering, for example, it may be worth NG discussing with Gasunie / Eon, netconnectgas / GRT / Fluxys on this subject, given the drive for consistency and co-ordination in EU. EB acknowledged that he had received representations regarding European implications and it was accepted that any proposals should be consistent with wider European requirements.

NW suggested the terms of reference might specifically state that consideration could be given to offering different products at different ASEPs.

It was agreed that the square brackets should be deleted from item 2 under Topics for Discussion in the draft Terms of Reference – making it explicit that the Transportation Model, which estimates Long Run Marginal Costs, is outside the scope of the review. In respect of exit, it was agreed that only impacts on exit from any proposed entry solution would be considered.

SL suggested that the objectives should be clearly stated. For example, incentivising long term bookings had been suggested as an objective and it was important to know whether this was the underlying objective if an appropriate solution was to be developed. EB responded that the review should consider the reasons for increasing the proportion of revenue recovered through capacity, as opposed to commodity, charges, or not. Increasing the recovery proportion through long-term bookings (eg QSEC) would stabilise prices so this should be considered as well. TD suggested that licence compliance should be an objective – which indicated the desirability of setting out the licence obligations in the Terms of Reference. The possibility of potential licence changes being considered within Ofgem for possible inclusion in the next price control review was raised. RiM agreed to establish if Ofgem had any proposals in mind at this stage.

**Action ECR09/01: Ofgem (RiM) to advise whether any potential licence developments are under consideration which would affect the areas under review.**

There was discussion on wider objectives, such as the impact on security of supply and it was agreed that the Terms of Reference should reflect these.

SL commented that simplicity was potentially important. JBa raised the issue of consistency of objectives - for instance, if capacity has been booked long term, increasing commodity charges could mean supplies go elsewhere.

National Grid NTS agreed to take into account these issues and redraft the terms of reference for agreement at the next meeting.

**Action ECR09/02: National Grid NTS (EB) to redraft Terms of Reference in light of discussion.**

### **3. Review Timeline**

EB outlined two potential timelines, leading to implementation no earlier than October 2010. RiM confirmed it was likely that a Regulatory Impact Assessment would be undertaken on the final proposals. The conclusion was that the timescale for October 2010 was tight but achievable. MD noted that April 2011 implementation would be after the QSEC auction, and suggested that consideration be given to implementation in time for this process rather than necessarily looking for implementation in October or April.

#### 4. Analysis

EB presented the current capacity/commodity split i.e. 39/61 for 2009/10. EB identified three main drivers which lead to capacity revenue being below target revenue – price; volume; and profile. EB concluded that the prices generated through the transportation model would be correct if the capacity product sold was annual, which it manifestly is not. There was some discussion on the assumptions underpinning the analysis, including whether it should include an assumption on within year profiling.

EB demonstrated that prices set prior to 2007, ie prior to the adoption of the Transportation Model, were lower than those which now apply, and this contributed to the current under-recovery. He then demonstrated the effect of within-year profiling. JBa asked for the analysis to be expanded to cover SO revenue and show a split between incremental and non-incremental capacity over time, to demonstrate the impact of the older ASEPs on the total picture. This needs to cover, say 10, years. EB agreed to this.

**Action ECR 09/03: National Grid NTS (EB) to expand the analysis presented to include SO as well as TO revenue, identifying incremental and non-incremental capacity, including projections across the next price control period.**

SL commented that the substitution and transfer and trade methodologies are encouraging long term bookings such that history may not be a good guide to the future when undertaking this analysis.

Discussion took place on whether the capacity in the summer months could be regarded as under booked or simply reflected the reality of physical flows. EB acknowledged that analysis of flows against capacity would be useful.

EB then presented ASEP by ASEP analysis that demonstrated under booking of peak capacity at certain ASEPs against the ten year statement peak, and the number and extent increased when considering average capacity bookings compared to forecast peak. TD commented that analysis of off-peak capacity bookings against anticipated demand might be more useful.

CW and JBa foresaw significant impacts in the future when revenue at LNG importation terminals was absorbed into the TO, as opposed to SO, price control. This may further reduce the proportion of revenue collected through capacity charges. It was suggested that the analysis consider this as well - the TO and SO capacity streams as well as the TO and SO commodity impacts versus the allowed revenues for future years needs to be explored.

SL suggested looking at revenue recovery if the existing level of capacity booking continued but all reserve price discounts were removed.

It was suggested that the level of the minimum price at entry (0.0001p/kWh) might not be the most appropriate. This led to comments regarding the use of negative charges which some believed should be considered as an option for the future, for example where positive system benefit is provided.

In reviewing the amounts made up by the different auction types, EB emphasised that QSEC prices were not indexed and suggested that this be reconsidered.

TD noted that the evidence presented effectively assumed an administered price regime applied, since the calculations assume all capacity is purchased at the prevailing reserve price. EB responded that he did not consider that introduction of administered prices was tenable.

EB then outlined some potential reform options, and highlighted a number of issues associated with each.

In reviewing the options, SL suggested that the commoditisation option should be discounted. EB suggested this equated to the do-nothing option and would at least provide increased certainty. CW disagreed and suggested that it would not even produce certainty – flows varied unpredictably from year to year and hence over or under recovery would be expected with full commoditisation. JBa suggested that “do nothing” was tenable but moving to 100% commodity, with implications for paying back auction revenue, was not.

SL had concerns about reviewing the Entry/Exit split – it had been reviewed recently and confirmed as appropriate. Despite this, the consensus was that this option should be retained.

CW suggested that consideration be given to the “optimum” price order i.e. whether QSEC prices should be lower than that for shorter term products.

TD suggested that the level of revenue recovery seen historically was driven by the capacity supply demand balance. A further option, therefore would be to look at the level of supply - reducing baselines, say to 50% of current levels, would be likely to transform the situation. JBa acknowledged this but did not favour this approach as the assets would still be there, with their associated capability. It was recognised, however, that baselines might be revisited as part of the forthcoming price control review.

EB then gave a presentation on competition with reference to the Herfindal Hirschman Index (HHI). This was relevant because, when introducing the clearing allocation obligation into the Licence, Ofgem had stated that sufficient competition existed at individual ASEPs. The HHIs presented shed doubts on the presence of effective competition at any of the ASEPs.

TD suggested that the analysis overstated the extent of competition since it was aggregated over all the auctions. Individual auctions could only have a lower number of participants.

SL suggested that the HHI measure is imperfect. There were efficiency benefits associated with scale that tended to promote a lower, rather than higher, number of participants and this could be the efficient outcome in a particular industry. NW added that the index did not apply to auctions as opposed to analysing a market. If there were only two participants in an auction, this would be expected to create significant competition and to affect the clearing price.

The meeting concluded by reconsidering the objectives. SL maintained that these were still unclear and it would assist the group if these were clearly stated and understood. It was agreed that National Grid NTS, and any other member of the group who wished, should set out the objectives for discussion and agreement at the next meeting.

**Action ECR 09/04: National Grid NTS (EB) to develop a list of objectives for the Review.**

It was agreed that it would be helpful to review developments in continental Europe. MD agreed to discuss this with National Grid NTS with a view to NG presenting something at the next meeting.

## 5. Any Other Business

It was agreed that the next meeting should be held on 7 October 2009 in London.

*Post Meeting Note: National Grid NTS has arranged the next meeting to be held from 10:30 to 13:00 at Ofgem's offices on 6 October 2009.*

**Action Log – Gas Transmission Entry Charging Review 09 September 2009**

<b>Action Ref</b>	<b>Meeting Date(s)</b>	<b>Minute Ref</b>	<b>Action</b>	<b>Owner</b>	<b>Status Update</b>
ECR 09/01	09/09/09	2	Advise whether any potential licence developments are under consideration which would affect the areas under review.	Ofgem (RiM)	
ECR 09/02	09/09/09	2	Redraft Terms of Reference in light of discussion.	National Grid NTS (EB)	
ECR 09/03	09/09/09	4	Expand the analysis presented to include SO as well as TO revenue, identifying incremental and non-incremental capacity, including projections across the next price control period.	National Grid NTS (EB)	
ECR 09/04	09/09/09	4	Develop a list of objectives for the Review.	National Grid NTS (EB)	