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Dear Julian,

Re: Modification Proposals 0195/0195A: "Introduction of Enduring NTS Exit Capacity Arrangements"

British Gas welcomes the opportunity to provide this representation in respect of UNC modification proposals 0195 and 0195A. British Gas supports modification proposals 0195 and 0195A with a preference for proposal 0195, and we set out below our ranked preferences for all of the exit reform proposals to be considered by the Authority.

There are currently 7 modification proposals on exit capacity reform for consideration by the Authority. Whilst we continue to hold a number of concerns and doubts about some of the benefits claimed to arise from these proposals, we recognise the obligation on National Grid to introduce enduring arrangements.

Of the original suite of proposals arising from 0116, we stated a clear preference for proposal 0116A as, in common with the majority of industry participants, we had been unconvinced of the need for major reform of existing arrangements. Recognising that the regulator had given a very clear indication that some revision was required, of the remaining 4 alternatives, we had a strong preference for proposal 0116CVV, as this addressed arrangements for User Commitment and Interruption but excluded the requirement for a flexibility product for NTS direct connects, which we could see no justification for.

There are two principle reasons why we now consider these more recent proposals to be preferable to proposal 0116CVV. First, they provide a means for booking enduring exit (flat) capacity outside of the regular annual process, and second they also require the provision of more specific information on flexibility usage on the NTS.

Support for Proposal 0195

Proposal 0195 offers a relatively acceptable package of arrangements that provides:

- assurances for National Grid (and the shipper community as a whole) around underwriting infrastructure investment by way of User commitments to pay certain future capacity charges; and
- a range of workable mechanisms for Users to procure the capacity they require for shipping gas.

Through discussions with Distribution Network Owners/ Operators at Transmission Workstream and Modification 0166 Review Group meetings, we are confident that their needs have also been reasonably accommodated via the proposal.

We must emphasise that our support for the proposal is based on 2 key considerations:

- (a) that some form of enduring exit capacity arrangements will inevitably be required of National Grid in accordance with its licence; and
- (b) of the options available, modification proposal 0195 most closely meets the objectives identified.

Proposal 0195A

With respect to the alternative, proposal 0195A provides a proxy for a longer term interruptible product by allowing Users to elect for a “non-peak” service thereby utilising capacity that would otherwise be unused. We are also supportive of this enhancement if it can be demonstrated that this can be achieved without detriment to the safe operation of the system and to the availability of capacity to other users without additional cost.

We also believe that the ‘foregone’ costs, i.e. those costs not recovered through the application of exit capacity charges to “non-peak” supply points, are inappropriately recovered via SO commodity charges, which is counter to the aims of cost-reflectivity.

On balance, therefore, we have a preference for Proposal 0195 over 0195A.

Exit (Flexibility) Capacity – “Flexibility Capacity”

We remain firmly of the view that any attempt to introduce commercial arrangements for flexibility capacity for customers directly connected to the NTS would be ill-conceived and would not provide any positive contribution towards the efficient, economic and transparent operation of the NTS.

Nor would it provide any basis for sensible and justifiable infrastructure investment. It has been confirmed by National Grid that flexibility capacity is a by-product of other investment decisions, and no investment would be undertaken itself to provide flexibility.

This is implicit in the suggested charging mechanism for flexibility capacity; it is not booked, referenced, or measured in any direct or meaningful way. Its utilisation (whatever that may mean) under different sets of circumstances is not attributable to any identifiable costs or benefits.

Similarly, we are not clear how flexibility capacity (overrun) charges would be derived in the absence of any clear cost-benefit assessment. Also, the mechanism for determining the quantity of flexibility capacity used in a day is essentially arbitrary and biased, i.e. based on the use of capacity over a 16-hour period compared with the flat average hourly rate over the whole day. Neither does it take into consideration any capacity benefits provided by Users when flows fall below the flat rate, i.e. contribute more flexibility to the system.

An important consequential effect of imposing commercial arrangements for flexibility exit capacity on the industry will be a distortion of the power generation market. The interoperability of the gas and electricity markets comes clearly into focus in this case and cannot be ignored when the various modification proposals are being considered. We believe that any prudent or sensible views or decisions on flexibility capacity cannot be considered without a full assessment of how both the gas and electricity markets will be affected, for that matter, also the impact upon carbon or other emissions markets.

However, notwithstanding the likely pitfalls described above, it remains clear that flexibility capacity will be an unquantifiable, unpredictable residual product. The recent paper on flexibility capacity provided to Ofgem by National Grid (titled “UNC 0116: Enduring Offtake – Information request on the availability of NTS exit flexibility capacity”) only served to underline the major uncertainty surrounding the assessment of the availability of flexibility on the NTS. With such uncertainty surrounding quantification, flexibility capacity does not lend itself to any form of commercial or investment regime.

We therefore remain firmly of the view that the desirable attributes of transparency, cost-reflectivity, efficiency and predictability of NTS charging and operation will be seriously undermined by introduction of commercial arrangements for flexibility capacity as proposed.

National Grid’s paper does not therefore provide any evidence or support in favour of flexibility capacity. The response to the paper by consultants TPA solutions, who were commissioned by Centrica to provide an independent expert opinion, supports this view and should be considered by the Authority when judging on the various modification proposals. A specific issue raised by TPA solutions concerned the geographical constraint aspect of flexibility capacity. To facilitate this understanding we consider it necessary that National Grid be required to publish hourly data on zonal linepack and use of this flexibility as advocated by proposal 0195.

In summary, since the understanding of flexibility capacity by industry participants has not been aided by the information provided to date, we believe that it would be neither prudent nor justifiable to introduce a commercial regime around this unquantifiable product. Also, the consequential impact on the electricity market, gas storage, inter-connectors and, ultimately, consumers needs to be modelled and assessed. We therefore believe that the

Competition Commission's finding, that the case for flexibility capacity has not been proved, still holds true.

NTS Exit (Flat) Capacity – Flat Capacity

We believe that the effort and level of debate spent on what we consider to be a spurious product – flexibility capacity – has detracted from a more considered approach to the provision of flat capacity. By carefully planning for and investing in flat capacity efficient pricing signals and system utilisation should be enhanced. Such a focus on flat capacity will also support efficient decision-making and investment among the Network Operators for both Transmission and Distribution. Any over-reliance on the booking of flexibility capacity well into the future to operate the networks could lead to transportation constraints and increased operating costs.

Similarly, one of the balances the network operators will need to make will be between the level of capacity investment to commit to and the amount of interruptible demand to procure or allow. Any uncertainty or over-reliance on flexibility capacity could therefore lead to under-procurement of interruptible products.

Costs

It is very difficult to assess the precise costs likely to be incurred as a result of the implementation of proposal 0195 but on a relative basis these would be significantly greater should flexibility capacity be introduced for direct NTS offtakes.

For simplicity, in addition to the above response, we also set out our thoughts below in the form of the Joint Office response template:

Support and ranking

British Gas supports the implementation of Modification Proposal 0195.

British Gas supports the implementation of Modification Proposal 0195A.

Our ranking of the 0116 and 0195 Proposals in facilitating the achievement of the relevant objectives, and whether or not we support implementation of each, is as follows (most favourable first): 0116A (support), 0195 (support), 0195A (support), 0116CVV (support), 0116VD (do not support), 0116BV (do not support), 0116V (do not support).

Extent to which implementation of the proposed modification would better facilitate the relevant objectives

Gas Transporter Licence Standard Special Condition A11.1

(a) *the efficient and economic operation of the pipe-line system to which this licence relates;*

Compared to the current UNC baseline, we do not believe that either proposal will enhance efficient or economic operation of the pipeline system. However, compared to the 0116 suite (excluding 0116A), both proposals provide a means for booking enduring exit (flat) capacity outside of the regular annual process (subject to certain User commitments being met) and they also require the specific provision of zonal linepack information by National Grid. The first of these enhancements will better facilitate both new connections to the NTS and significant load increases at existing offtakes. The second of these enhancements will ensure that data critical to the effective and efficient operation of the NTS will become public and help the industry to form a clearer picture of how system flow dynamics are managed.

(b) *so far as is consistent with sub-paragraph (a), the coordinated, efficient and economical operation of (i) the combined pipe-line system, and/ or (ii) the pipe-line system of one or more other relevant gas transporters;*

As set out above, the provision of zonal linepack data by National Grid will endow stakeholders with a clearer picture of NTS operations and capabilities.

(c) *so far as is consistent with sub-paragraphs (a) and (b), the efficient discharge of the licensee's obligations under this licence;*

National Grid clearly has a Licence obligation, imposed upon it by Ofgem, to introduce reforms to the prevailing offtake regime. By implementing reforms to the prevailing arrangements, we believe that both of these proposals achieve this relevant objective.

(d) *so far as is consistent with sub-paragraphs (a) to (c) the securing of effective competition:*

(i) *between relevant shippers;*

We consider that 0195 better facilitates the securing of effective competition between relevant shippers and suppliers as all sites will be required to pay for the pipeline capacity that they use on equal terms. By contrast, 0195A continues to permit sites to benefit from a gas pipeline service but not fully contribute to the cost of that pipeline.

(iii) *between DN operators (who have entered into transportation arrangements with other relevant gas transporters) and relevant shippers;*

We have carefully considered whether 0195 and 0195A create or maintain any undue discrimination between different classes of offtake – i.e. DNs and directly connected customers. Whilst it is clear that both proposals continue the current differences in treatment between these two classes of User, we believe that such differences are fully justified by the very different natures of the offtakes. We therefore believe that the extension of the current discriminatory arrangements is not undue.

(f) *so far as is consistent with sub-paragraphs (a) to (e), the promotion of efficiency in the implementation and administration of the network code and/or the uniform network code.*

Compared to the current arrangements, we believe that both of these proposals add unnecessary complexity and inefficiency to the UNC, for example by virtue of a complex set of rules for booking and surrendering offtake capacity. Since we believe that such fundamental – or indeed any - reform is unnecessary, any of the proposals other than 0116A will incur a detriment to this relevant objective.

The implications of implementing the Modification Proposal on security of supply, operation of the Total System and industry fragmentation

We believe that 0195 will enhance security of supply by providing certainty that all sites are firm and met by system capability, whereas under 0195A there must remain some residual uncertainty about whether non-firm sites will self interrupt at the required demand level, or indeed at all.

The implications for Transporters and each Transporter of implementing the Modification Proposal, including

a) implications for operation of the System:

Both proposals will require NG to publish specific data relating to the use of flexibility. There may be a cost associated with this.

c) extent to which it is appropriate to recover the costs, and proposal for the most appropriate way to recover the costs:

It was British Gas' understanding that any costs arising from the implementation of Exit reform were to be borne by National Grid as a result of revenues generated from the sale of the DNs.

The implications of implementing the Modification Proposal for Users, including administrative and operational costs and level of contractual risk

Both proposals introduce significant complexity to the UNC, compared to the current UNC baseline, in respect of offtake arrangements.

The implications of implementing the Modification Proposal for Terminal Operators, Consumers, Connected System Operators, Suppliers, producers and, any Non Code Party

Under 0195, some customers will see an increase in costs as a result of having to start paying capacity charges (effectively due to the removal of the current capacity cost cross subsidy underwritten by fully firm customers). Similarly, some customers will see a reduction in capacity charges when all customers have to start paying their way.

Analysis of any advantages or disadvantages of implementation of the Modification Proposal

Please see a more detailed analysis in the introductory text, at the top of this response.

Please contact me if you would like to discuss any aspect of this representation.

Yours sincerely,

Graham Jack
Commercial Manager