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Mr. John Bradley
UNC Panel Secretary
Joint Office of Gas Transporters
1st Floor South
31 Homer Road
Solihull
West Midlands
B91 3LT

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Dear John,

RE: Modification Proposal 0246/A/B "Quarterly NTS Entry capacity User Commitment"

Thank you for the opportunity to comment on this proposal. Overall British Gas:

- Does not support 0246
- Does not support 0246A
- Supports 0246B

Background

It is disappointing that, after a number of years of operating under the entry capacity "User Commitment" regime such significant flaws have come to light. Whilst the industry has generally rallied round to try and mitigate the worst impacts of the flaws in the current regime, i.e. through UNC Review Group 0221 and these subsequent UNC Modification Proposals, we remain of the view that the root cause of the current problems are to be found in the underlying principles contained within the Gas Transporter Licence.

It is our view that none of these proposals – including our own – fully rectify the exposed defects, and indeed all add further cost, complexity and uncertainty to an already challenging entry capacity regime.

We therefore believe that whichever, if any, of the current proposals are directed by Ofgem for implementation, this process should be seen as only the starting point for reforms which will necessarily include changes to the Gas Transporter Licence in the longer term.

It should also be recognised that these proposals do nothing to prevent National Grid from benefiting from up to £95m of unearned, windfall revenues that look set to derive from the current situation with the Fleetwood NTS entry point. This is due to be funded by shippers and, almost certainly therefore, customers. We continue to look to, and work with, Ofgem to arrive at an appropriate solution to this issue.

Modification Proposal 0246

This proposal seeks to create a UNC default position where a User fails to post transportation credit in full, when requested. We fully support this aspect of the proposal. The proposal would, upon implementation, also require the immediate securitisation of 10% of the value of all existing QSEC capacity holdings as well as securitisation of 10% of the value of all new QSEC capacity being sought in the QSEC auction held in the relevant year. Options available to shippers to provide such security will be Letter of Credit and Deposit Deed.

Whilst we understand the reasons behind the proposer's thinking, we do not believe that it is either necessary of efficient, and indeed may be harmful, to require the securitisation of all existing QSEC capacity or to restrict the credit tools available to the extent proposed, particularly in the current economic climate. We hold this view for a number of reasons, as set out below.

Scope for default on current holdings

A key element of discussion during Review Group 0221 process was whether a change in the transportation credit regime to require the securitisation of existing holdings would lead to an increase in Users "defaulting" on – or handing back – capacity. Drivers of this behaviour could, for example, be where that capacity had reduced in value and could now be bought cheaper than the original purchase price, or the cost/value equation simply no longer looks attractive.

We believe that, with its requirement for securitising all existing QSEC holdings, proposal 0246 does indeed contain scope for Users to consider this as a course of action. We also believe that inclusion of the term "cancellation fee" within the proposal may appear to legitimise this course of action, whilst further undermining the established "user commitment" principle.

Retrospective costs

We believe that Users will generally give extremely careful thought to entry capacity purchases based primarily upon the price they have to pay and the value they can derive by flowing gas against that capacity. Users will set their prices to their customers accordingly. It is evident, however, that by requiring Users to place credit at a cost to themselves, proposal 0246 would change the cost/value dynamics of existing capacity holdings. That amounts to retrospection.

We also speculate that in some cases, had this additional cost been known about at the time that the capacity was purchased, in a number of cases the User concerned would have decided not to buy the capacity.

Existing vs future risk

It is our view that the majority of risk from shipper default comes from bids for capacity that are to be made in the future, and in particular future incremental capacity bids. We also believe that the risk of default has been heightened by the exposure of the existing flaws in the user commitment regime, which clearly open up capacity trading opportunities.

We do not have figures to support this assertion, but believe that this should be a key area for examination within the proposed Ofgem Regulatory Impact Assessment (RIA) on these modification proposals.

We would also highlight that our understanding of 0246 is that it would give rise to a cost across the industry of £4m p/a to securitise 10% of a total estimated annual risk of £20m p/a – i.e. £2m. This further underlines our objection that this is not an economic or efficient outcome.

Restriction of credit tools

Again, we understand why the proposer of 0246 believes it necessary to restrict the use of credit tools available to shippers, but do not agree that this is appropriate in the circumstances.

The UNC sets of a regime containing a range of credit tools which can be used by shippers for securitising transportation credit, based upon an Ofgem best practice guidelines document. This regime has recently been called into question, and a UNC Review Group (0252) established in order to ensure transportation credit tools remain fit for purpose. Therefore, we do not believe it is appropriate for proposal 0246 to seek to restrict such credit tools ahead of the outcome of the Review Group. Further, doing so will significantly increase the costs of credit to a large number of Users who would otherwise rely, for example, upon Parent Company Guarantees (PCG).

We would also point out that in some cases, the credit rating of the User's parent company (which it would not be allowed to use) could equal or exceed the credit rating of the financial institution providing the Letter of Credit (which the User would be allowed to use). Such an arrangement would appear slightly odd.

Modification 0246A

We understand proposal 0246A to be broadly similar to 0246, except in the area of available credit tools.

As with 0246, we fully support the intention to make a default of any failure to pay in full the required security against QSEC capacity. We also fully agree with the proposer of 0246A that the current range of credit tools should remain available to Users pending the outcome of Review Group 0252.

However, our main reason for not being able to support 0246A is the requirement to securitise all existing QSEC holdings which, for the reasons set out above, we view to be excessive and inefficient.

Modification 0246B

As proposer, we fully support implementation this modification proposal.

In raising it, we have sought to overcome some of the difficulties we perceive with 0246 (and to a lesser extent 0246A).

<u>Existing vs future risk and Scope for default on current holdings</u>

Whilst we cannot provide supporting figures, we perceive that the majority of risk from cost socialisation faced by the shipping community comes from new (i.e. yet to be booked) capacity, especially incremental capacity. We therefore feel that money spent in protecting against future failure in this way is justified. In focusing upon this, however, we do not believe that we are unduly exposing the shipping community to increased risk from default on existing capacity.

It is our understanding that when National Grid requests the placement of credit, it does so by way of a single aggregate figure to each shipper covering that shipper's entire capacity holding. Payment of the invoice in full will securitise all of the relevant capacity, whereas any element of non-payment against the total figure will, under this proposal, result in a default. This will jeopardise all of that User's capacity across all ASEPs. We do not believe that this is a course of action that many, or indeed any, Users will be willing to pursue.

Retrospective costs

By seeking to secure only future QSEC bookings, this proposal will avoid the issues associated with cost retrospection, as set out above.

Restriction of credit tools

As set out in 0246B, we believe that it is appropriate for the full suite of transportation credit tools to remain available to Users until such time as it is credibly demonstrated that elements of the current regime are no longer appropriate. We anticipate that Review group 0252, and any subsequent UNC modification proposals, will resolve this element of the debate in due course, and would not support piecemeal dis-application of the current rules ahead of any such outcome.

In terms of furthering the relevant objectives, we believe that by closing the existing loophole which allows indefinite deferral of user committed capacity, all proposals including 0246B would benefit the efficient and economic operation of the pipeline system. This same objective is furthered by introducing a deterrent to speculative auction bidding behaviour.

For these reasons, we also believe that all three proposals assist in the efficient discharge of the licencees obligations, particularly in respect of providing new entry capacity only when absolutely required.

Finally, we are a strong advocate of cost targeting, which improves competition between shippers. It is evident that current UNC arrangements allow potentially massive costs to be smeared across shippers, with the User who gave rise to those costs not only avoiding such cost contributions, but also potentially benefiting from the originally signalled capacity at a much cheaper price once the initial 5 year SO cost recovery period has passed. While all three proposals seek to tackle this issue, we believe that 0246B does so in a much more cost efficient way.

Should you have any queries with regard to this response please do not hesitate to contact me.

Yours sincerely,

Chris Wright
Commercial Manager