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Our Ref.  
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6 December 2006

Dear Julian,

Re: Modification Proposals 0116V/0116VA/0116VB/0116VC/0116VD: "Reform of the NTS Offtake Arrangements"

Thank you for the opportunity to comment on this Modification Proposal and its alternates.

- British Gas Trading does not support implementation of Modification Proposal 0116V
- British Gas Trading fully supports and wishes to comment on the implementation of Modification Proposal 0116VA
- British Gas Trading does not support the implementation of Modification Proposal 0116VB
- British Gas Trading supports the implementation of Modification Proposals 0116VC
- British Gas Trading does not support the implementation of 0116VD

Amongst these proposals, we would rank our support in the following order:

1. 0116VA
2. 0116VC

Although we do not support the implementation of any of 0116V, 0116VB or 0116VD, should Ofgem decide not to implement either 0116VA or 0116VC, our preferences of the remaining are:

3. 0116VD
4. 0116VB
5. 0116V

We set out our thinking in more detail below.

The process of discussion and design of a suitable regime has taken place over a number of years and a number of key points have ensued from those discussions. Many parties involved in those discussions remained unconvinced that there was a requirement for a) identical arrangements for all connectees, and b) the need for short-term and long-term measures for both Capacity and Flexibility. The original Modification Proposal (0116V) seeks to implement identical arrangements for all connectees to the National Transmission System (NTS) to acquire Capacity and Flexibility, both in the short term (constrained period) and in the longer term (unconstrained).

Following the issue of the original Proposal a suite of Alternate Proposals have been raised. The extent of change put forward by these Proposals ranges from one that advocates continuation of "Business as Usual", to two that set out regimes close to the original Proposal but with some minor, but important, amendments.

There are two key elements of the original Proposal. The introduction of a facility for the commitment to incremental system capacity, termed "Flat Capacity" and a regime to allocate and control the use of Flexibility. Within the industry discussion there has been a great deal of uncertainty whether limitation of this use of Flexibility is more closely related to the preservation of linepack. In this context Flexibility is defined as a flow rate which varies from 1/24<sup>th</sup> of the End of Day quantity. It is acknowledged by all concerned that it is very difficult to measure this accurately.

The original proposal includes a methodology which would simply compare the average flow rate at the earlier portion of the day (06.00 until 22.00) with the average flow rate throughout the day. This methodology treats any such variation, be this is more than the average (positive flex) or less than the average (negative flex) as incurring a Flexibility Charge or overrun. It does not recognise that change of flow rate to a lower consumption - i.e. the use of negative flex - may assist the System Operator (SO) in preserving linepack.

It is without doubt that most of the concern expressed during the industry discussions has been related to the operation of a Flexibility Regime. Our own Alternate Modification Proposal (0116VC) would introduce the intended arrangements for allocation of incremental "Flat Capacity" but would not introduce a regime for Flexibility allocation. Instead, it would monitor the extent to which system flexibility is used. This would provide a sound basis upon which the necessity for, and the design of, any mechanism to be adopted for the rationing of flexibility could be judged for the future.

Within that Alternate Proposal, a catalogue of issues associated with the implementation of such a regime was included. For ease of reference these are replicated below:-

- 1. Investment Signals – The signals for economic and efficient investment is cited as one of the main objectives of National Grid's proposal. National Grid have clearly stated that there would be no investment in the network specifically for Flexibility. (This is also consistent with NGG's licence obligation to invest for the 1-in-20- peak day.) The Flexibility that exists is a bi-product of the establishment of the size of the Transmission network, which is itself driven by (flat) capacity requirements. It follows logically from this that the removal of the process for sale of a Flexibility product does not detract from any objective of the original Proposal to provide investment signals.*
- 2. Quantification of the Flexibility Product – National Grid have demonstrated convincingly that the amount of Flexibility available on any single day is dependent upon a number of unpredictable factors. Therefore it is impossible to forecast, with any level of confidence or reliability, the amount of Flexibility available more than a day or so*

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ahead. This does not support the sale of a Flexibility product to all Users on a long-term basis, which is most unlikely – for a number of reasons – to be an economic and efficient solution.

3. *Artificial Scarcity of Flexibility – Given the unpredictability described in (2) above, the amount of Flexibility which can be offered in the long-term is of necessity limited to the lowest number that can be guaranteed by the Transporter to be available at a date far in to the future. Experience has shown that all Users’ and Distribution Networks’ use of flexibility is unpredictable and not co-incident. Therefore in order to be certain of acquiring sufficient Flexibility for days of maximum use it is necessary to book Flexibility for all days, perhaps with a seasonal profile. Should all Users and Distribution Networks simultaneously book sufficient Flexibility for their maximum Flow rate variation on all days far into the future, this will inevitably exceed availability and this demand upon the system would never be co-incident.*
4. *Sub-Optimal assessment of System Capability – for the reasons outlined above, the assessment of capacity available in the long term would be conservative and would under-estimate the true potential of the system.*
5. *Absence of secondary trading or transfer of flexibility – For those parties able to forecast more reliably their use of Flexibility in advance, mainly DNs, this is likely to be for peak requirements across all days taking account of seasonality. It is likely that this would not be released to other users until there was certainty that it would not be required by the DNs themselves. This would be very close to the gas day, if not within day. This would result in unused Flexibility being unavailable to other Users, i.e. the original Modification would place an artificial Flexibility constraint on the system.*
6. *Exposure to flexibility overrun charges as result of other Users’ flow profiles – particularly at locations where there are multiple Users and where there are bi-directional flows, a User may incur a penalty as a result of other Users’ flow profiles. The arrangements within the original proposal do not address this problem.*
7. *Contrary to EU Regulation 1775/2005 on conditions for access to gas transmission networks. Article 3 requires transmission system operators to actively pursue convergence of tariff structures and charging principles and for tariffs not to restrict market liquidity or distort trade across borders of different transmission systems. The Proposer believes the original proposal would hamper liquidity and trade across the IUK and Moffat interconnectors. It is also contrary to convergence with the regimes in neighbouring Member States and therefore working against the ambitions for a liberalised European market. The Proposer also believes that the original Modification Proposal may prevent the unencumbered release of the full capacity potential of the network (Article 5)*
8. *Extreme Complexity - All Users and Transporters would be required to establish and maintain sophisticated systems to manage flexibility.*
9. *Exposure to risk – the regime proposed in the original version would create high risk for Users unable to acquire flexibility due to the reasons contained in 2 & 3 above.*
10. *High Costs for Users and Consumers – The necessity for such systems will generate costs. The acquisition of Flexibility will generate costs. The exposure to overrun charges and SO Commodity (flexibility) charges would also add costs.*

**11. Impact upon other regimes – A significant number of NTS connected customers are power stations. The need to book Flexibility for such customers is particularly difficult as the within day profile of gas flows will not be known until very close to the gas day. Should power stations be unable to secure flexibility in the long term, due to uncertainty, and not be able to secure flexibility in the short term, due to the lack of effective Use it or lose it (UIOLI) process (as 5 above), they would be unable to respond to the requirements of the power regime. In that sense, the original Modification would cut across another legitimate regulatory concern, i.e. to facilitate a flexible and economically efficient pattern of power station despatch.**

Largely predicated on this reasoning, we are strongly opposed to the introduction of that element of the original proposal, which would introduce this Flexibility regime for all connectees.

### **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;*

We recognise that the introduction of a long-term capacity booking regime, to parallel that which applies at Entry, may enhance the ability to plan economically and efficiently for future use of the system. In particular, it may supplement the existing arrangements through planning processes and Advance Reservation of Capacity Arrangements (ARCAs). However the experience at Entry Points has failed to indicate that auctions provide any greater signal than ARCAs. These currently fulfil this function and appear to provide a reliable methodology if consistently applied.

We do not believe that the long-term commitment to a Flexibility product assists at all in this respect. In a more operational context, we believe that the existing tools available to the SO are sufficient for economic and efficient operation of the system until it can be demonstrated that this is not the case. As suggested above, we also believe that this proposal could actually detract from the operation of the pipeline by disincentivising Users, who do not hold the required flexibility, from reducing their within-day consumption.

**Introducing a flexibility regime based around what many players consider to be artificial scarcity is neither economic nor efficient. It will limit use of the inherent existing flexibility of the NTS, and will drive Users towards inefficient flexibility purchasing decisions, and possibly also unnecessary investment in off-NTS storage and/or alternative fuel capability.**

(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;*

Our comments in (a) above are applicable in this respect also.

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

We are aware that the licensee is under an obligation to provide an enduring regime for the allocation of capacity in the long term. It is our view that this obligation does not extend to the introduction of a flexibility regime for all Users, and that the requirement on the licensee is fully satisfied by Modification Proposal 0116VA and 0116VC. Proposals 0116V, 0116VB and 0116VD extend beyond current obligations in our view, and can therefore be seen as inconsistent with the efficient discharge of the licensee's obligations.

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

- (i) *between relevant shippers;*
- (ii) *between relevant suppliers; and/or*
- (iii) *between DN operators (who have entered into transportation arrangements with other relevant gas transporters) and relevant shippers;*

Our major concern with these proposals are related to the costs involved. This is particularly acute with regard to Flexibility. Although there are some identified costs associated with implementation and operation, there will also be costs associated with the manner in which Customers, and Users on their behalf, will need to amend their offtake flows to remain within the limitations of Flexibility secured. This could be the case even where there is no system constraint and Flexibility is physically, if not commercially, available.

In respect of item (iii), we believe that 0116V, 0116VB and 0116 VD distort competition between DNOs and relevant shippers by introducing unnecessary competition for an artificially constrained product, but with different drivers and different abilities to recover costs.

We believe that this will serve to restrict and dampen competition.

- (e) *so far as is consistent with sub-paragraphs (a) to (d), the provision of reasonable economic incentives for relevant suppliers to secure that the domestic customer supply security standards (within the meaning of paragraph 4 of standard condition 32A (Security of Supply – Domestic Customers) of the standard conditions of Gas Suppliers' licences) are satisfied as respects the availability of gas to their domestic customers; and*

We do not believe that any of the proposals will impact upon this requirement.

- (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.*

We do not believe that any of the proposals will impact upon this requirement.

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

With regard to security of supply, we believe that the introduction of a Flexibility regime may have a detrimental effect. Where a NTS connectee is required to reduce or cease offtake of gas in order to support security of supply, it could be subject to a Flexibility Charge or Overrun charge if this were to be within day. The original Proposal 0116V does not allow for such actions. Similarly there could be impacts on the electricity market if directly connected power generators are constrained due to holding insufficient Flexibility, thereby preventing them from responding to prevailing market conditions.

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

- a) implications for operation of the System:**
- b) development and capital cost and operating cost implications:**
- c) extent to which it is appropriate to recover the costs, and proposal for the most appropriate way to recover the costs:**
- d) analysis of the consequences (if any) this proposal would have on price regulation:**

Although it is asserted that the introduction of a flexibility regime will facilitate control of the use of system flexibility, it is unproven that there is any need at this time to do so. To implement this radical change at this time to cope with unseen, unlikely and even if possible, admittedly rare events is not efficient or economic operation of the system. Costs directly incurred by each party are likely to be passed on through the market to customers, and the extent to which the Transporter's costs are efficient will be passed on through charges. Ultimately, this will result in increased costs to customers, with no tangible resulting benefits.

## **The consequence of implementing the Modification Proposal on the level of contractual risk of each Transporter under the Code as modified by the Modification Proposal**

We do not identified any impact upon the level of contractual risk of the transporter.

## **The high level indication of the areas of the UK Link System likely to be affected, together with the development implications and other implications for the UK Link Systems and related computer systems of each Transporter and Users**

The precise details of systems required to deliver any of these Proposals have not yet been resolved. It is expected that will be delivered by changes to Gemini systems. There will also be changes required to existing systems of both Transporters and Users. Our initial assessment of this requirement indicates that most of the complexity, and therefore cost, will be associated with the monitoring and management of flexibility use.

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

Again in this respect there are different implications of the various Proposals. We believe that the implications for Users of an enduring regime for allocation of incremental Exit (Flat) Capacity will be modest. In contrast the implications for Users of the entire regime proposed by 0116V, 0116VB and 0116VD will be much more significant. In terms of operational costs and associated contractual risk it is difficult to quantify these precisely but these will fall in three specific areas. Firstly, implementation costs of developing systems and training staff to manage this regime.

Also there will be costs associated with monitoring offtakes within day and securing any levels of Flexibility identified as necessary. Lastly, there will be risks and commensurate costs associated with operation of the Customer's plant in such a way as to remain within the limits of the Flexibility available. As detailed elsewhere in this response, where the scarcity of system capability is real these costs and risks may be considered reasonable. But in light of the manner in which Flexibility may be identified and offered to Users, this scarcity is more likely to be caused by holders of Flexibility being unable or unwilling to release it to the market unless they have certainty that it will not be required. Without an effective Use it or Lose It (UIOLI) mechanism, this will not be available to the market.

There are two specific situations where there are particular problems for Users and non-Code parties with the proposed regime for Flexibility.

The majority of NTS Connectees are served by Shared Supply Meter Points (SSMPs). These are virtual meter points, which allow a number of Users to deliver gas to a single physical offtake. This can range from just two shippers delivering gas to a consumer to a number in excess of thirty in the case of an interconnector or storage facility. The use of system Flexibility is determined by the total flows exiting the NTS. Each individual User, subject to their UNC obligations, will advise an expected pattern of flow of the gas being delivered and, if the regime were introduced, make provision for Flexibility to facilitate this. The individual User will have no control over the actual pattern adopted to flow the gas.

A further complexity overlaid to this issue is that of bi-directional flows, specifically Storage facilities and some interconnectors. These will also be SSMPs in most cases. This aspect further compounds the difficulty in assessing the requirement for flexibility and hence cost, or the control of the pattern of gas flows to match flexibility available. Managing this risk will again impose unnecessary costs on the market.

**We also question the impact any of the proposed Flexibility regimes on future investment in electricity power generation, given the additional costs and operating constraints that such regimes will attract. Any such investment disincentive comes at a time when there is significant focus upon GB generating margins and plant availability, with potential knock on effects for security of supply.**

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

As these Modification Proposals relate to arrangements for Exit from the NTS they would not impact upon Producers and Terminal Operators. However, all Exit points will be impacted, including those relevant to this section i.e. Connected System Operators and Non Code Parties. The issues for all connectees are detailed elsewhere in this response but at certain Exit points the difficulties are compounded. It is notable that the major cause of these difficulties also is the Flexibility regime.

Please see comments above under “**The implications of implementing the Modification Proposal for Users, including administrative and operational costs and level of contractual risk**” with regard to SSMPs and bi-directional flows. The only solution to this issue offered within Proposal 0116V is the establishment of an “overrun agent”. Having been considered within industry discussions it is our view that this remedy is completely inadequate in practical terms as the operation of this role would involve extreme contractual risk and would require very complex contractual terms to manage this risk. To the best of our knowledge, no parties that could potentially fulfil this role have come forward to provide such a service. Without this overrun agent, or the appointment of a lead shipper (which is unlikely to be acceptable to multiple shipper sites, it appears that individual User profiles would have flexibility charges applied where there were a “use” of Flexibility at that Exit point.

## **Consequences on the legislative and regulatory obligations and contractual relationships of each Transporter and each User and Non Code Party of implementing the Modification Proposal**

BGT believes that the proposed introduction of a Flexibility product, as set out in 0116V, 0116VB and 0116VD is not driven by regulatory requirements. If implemented, however, any of these three proposals will have knock on implications for existing contractual arrangements, include arrangements to cover multiple shippers sites, for example.

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

### **We have identified the following advantages:**

With regard to the operation of a long-term process for the allocation of Exit (Flat) capacity, we can see that there could be some small advantage if it is shown to enhance the processes already in place (planning cycle, ARCAs, etc.) to provide necessary signals for investment in incremental capacity. However, our experience with the Entry regime indicates that such an advantage would be small, or even non-existent.

We can identify no advantages in the proposals to introduce this regime to allocate and manage system Flexibility.

### **We have identified the following disadvantages:**

With regard to the part of the Proposals, which relate to Exit (Flat) Capacity there are some disadvantages in respect of an additional process to introduce and a



longer period of commitment is required to trigger incremental capacity and to release unwanted capacity.

However the disadvantages of a Flexibility regime are many and various and detailed throughout this consultation response.

**The extent to which the implementation is required to enable each Transporter to facilitate compliance with safety or other legislation**

We are not aware of any such requirement

**The extent to which the implementation is required having regard to any proposed change in the methodology established under paragraph 5 of Condition A4 or the statement furnished by each Transporter under paragraph 1 of Condition 4 of the Transporter's Licence**

We are not aware of any such requirement other than the obligations incorporated into Transporters licences following Distribution Network Sales, **which do not extend to the provision of a Flexibility product.**

**Programme for works required as a consequence of implementing the Modification Proposal**

There will be system development required to different degrees dependent upon the proposal implemented. Proposal 0116VA will require very little. Proposal 0116VC, introducing only a regime for allocation of (Flat) Capacity and monitoring of Flexibility utilisation will require more work but still of a relatively modest nature. Proposals 0116V, 0116VB and 0116 VD, introducing both Flat Capacity and a full Flexibility regime, will require works of a much more complex and detailed nature. The programme of implementation will need to reflect this level of complexity.

**Proposed implementation timetable (including timetable for any necessary information systems changes)**

We recognise that to achieve the target implementation date, the first elements of the long term sale will need to be in place prior to July 2007. With this in mind we hope that the maximum lead time is available for design and implementation of systems. Any delay caused by the non-acceptance of the Price Control starting in April 2007 may prejudice the timescale for this new regime, particularly if it were to be more complex.

**Implications of implementing this Modification Proposal upon existing Code Standards of Service**

We do not believe there are any implications upon existing Code Standards but there will need to be some accommodation of this regime within the SO Incentive arrangements both for NTS and Distribution Networks.

## Further Comments

We are of the view that the existing arrangements are, in the main, fit for purpose and are not persuaded that any major reform is urgently required. We understand that this view is shared by the majority of industry parties.

However, we do recognise that there is currently a licence obligation to deliver some elements of these proposals. It is our view that the current regime meets most of the requirements, however the provision of a regime for the allocation of incremental Flat Capacity certainly meets and exceeds this requirement.

As stated above, it is our belief that the original Modification Proposal 0116V, and alternates 0116VB and 0116VD, significantly exceed the requirements of this obligation.

The other elements of Modification Proposal 0116V is built upon a supposition that there is already a need to limit the use of Flexibility. The National Transmission System has a significant amount of flexibility available both by virtue of the nature of a major high-pressure pipeline system and of its design to accommodate the pattern of flows, input and offtake, which are experienced. Although it is accepted that there has been a change in the pattern of these flows, and that further change may be expected in the future, there is a high degree of scepticism that the system is close to, or even approaching, the limits of capability.

Therefore, it is our view that a prudent route forward would be to implement an Enduring Regime, either that currently in place or as specified in 0116VC, for allocation of Flat Capacity and to institute an open and transparent methodology for monitoring usage of Flexibility.

It is our contention that this will identify the actual pattern of usage in such a manner that if it is necessary to implement radical measures relating to Flexibility, such as those that have been outlined, it will become apparent well in advance.

Based upon these two points, it is our view that Modification Proposals 0116VA and 0116VC deliver the requirements necessary at this time. Proposals 0116V, 0116VB and 0116VD go far beyond these requirements and introduce high levels of complexity, and commensurate costs, upon Users, and in turn their customers, with few or no identified benefits.

As proposer of Alternate Modification 0116VC we firmly believe that our proposal provides a pragmatic and workable solution, and is therefore our preferred way forward if the status quo is not acceptable.

Please contact me if you require any further information.

Yours sincerely,

Mike Young  
Commercial Manager