

6th December 2006



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Dear Julian,

**Re: Modification Proposals 0116V/0116A/0116BV/0116CV/0116VD:
"Reform of the NTS Offtake Arrangements"**

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

Centrica Storage Ltd (CSL) does not support implementation of Modification Proposal 0116V.

CSL supports the implementation of Modification Proposal 0116AV.

CSL does not support the implementation of Modification Proposal 0116BV.

CSL supports the implementation of Modification Proposals 0116CV.

CSL does not support for the implementation of Modification Proposal 0116VD.

For the alternates which CSL supports, we would rank these in the following order:

- 0116A; and
- 0116CV

For those we do not support we rank them in the following order of preference: alternate 116VD; alternate 116BV and finally Modification Proposal 116V.

CSL has been actively involved in the numerous industry workshops tasked with designing an enduring regime for NTS exit. Our overarching conclusion arising from this involvement is that the case for the introduction of new capacity and flexibility arrangements has not been proven. In particular we have serious reservations regarding the introduction of a flex product and how this impacts on the economic and efficient operation of the NTS. For this reason, CSL supports the Eon proposal to continue as at present and the British Gas Trading proposal to continue as at present with the flex product only applicable to DNO's with the monitoring and publishing of utilisation of flex to further inform the requirement for a process to allocate and ration flex.

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CSL offers the following comments in support of the stated position above:

Common arrangements

We understand that the approach adopted for exit reform included the condition that common arrangements should be implemented for all classes of NTS users; Distribution Networks (DNs), Direct Connects (DCs) and bi directional sites, unless users can be separately identified by their cost to serve. CSL does not agree with this view and believes that in accord with the obligation for the efficient and economic operation of the NTS, there are grounds to offer different arrangements to different classes of NTS exit customer. CSL considers that this is of particular concern when considering the introduction of a mechanism to allocate flex. CSL believes that the costs to serve for interruptible sites are different to the costs to serve of firm peak demand as there is no investment in the system to supply interruptible load.

CSL prefers 116A over 116CV primarily because the 116CV, consistent with the original Mod, proposes that all supply points buy firm capacity. The implications of this are that there will be little benefit of customers having interruptible contracts therefore unnecessary investment will be required to provide firm capacity to these users. We also fail to see why NGG would enter into contract arrangements to buy back firm capacity for a site that does not use peak capacity.

The purpose of introducing a flex mechanism is to provide the price signals that will lead to the efficient and economic use of diurnal swing. This is predicated on users of flex having the choice of whether to use diurnal swing from the NTS or not.

DCs and bi-directional sites (including storage and Interconnectors) have very limited choice for varying flow over night i.e. swing, and therefore any flex mechanism will not influence their actions. For example power stations flow rates are driven by gas price vs power price and storage facilities change their flow rates as a response to the spot price (driven by balancing mechanism).

However, DNs having no control of load (except for daily interruption) and whose actions are not driven by price utilise diurnal storage either from within their networks or from the NTS. The introduction of a flex allocation mechanism will therefore affect their actions. We therefore assert that there is good reason to only include DNs in such a mechanism.

Inequitable transfers of monies

The cost from the flex mechanism will be passed on to the balancing mechanisms through lower bid prices and therefore the only type of users to be influenced by this will be those with diurnal storage (who can manage their position) and enable those users to make commercial gain i.e. cost pass back thru smearing mechanism

The above remains true until such a time that swing becomes constrained. This situation could come about because of:

- increase in domestic demand (unlikely).
- decommissioning of diurnal storage facilities.

Although swing has historically been available from beach supply points, given the reduced UKCS supplies and the inefficiencies of proving swing through long distance gas supplies, this provision is unlikely to be substantive or economic.

We therefore conclude that the proposed flex mechanism can only lead to the transfer of monies from those without diurnal demand to those with diurnal facilities which creates a one sided incentive mechanism.

Inappropriate targeting of costs

Diurnal swing exists to serve the domestic market and the monies required for accurate/efficient cost targeting should be directed solely at these users/market. This mechanism will fail to do this and move costs onto DCs and bi directional sites. Inclusion of other connections will only serve to dilute any signals from the mechanism. We understand that 116VD may enable other facility types to participate in the provision of flexibility but only at the cost of the balancing mechanism.

This mechanism completely ignores system input flows which can have an equal if not greater influence on diurnal flexibility. This can be used to discriminate in favour of those inputs.

A DC or bi directional site who reduces offtake due to commercial or operational decisions, for example a balancing action, a reduction in end of day demand, a response to the power market or through plant failure, could suffer extreme penalties under the proposed mechanism which is in fact a system balancing problem. This may lead to inefficient targeting of costs and may cause unintentional actions.

Inefficient Operation

NG suggests the IOPN may only be submitted up to 12:00, as a result this prevents users and facilities from varying their offtake profiles after this time and thus prevents these sites from responding to the balancing market. This will lead to increased balancing costs and prevents users balancing through the use of demand side mechanism..

Discrimination between bi directional and non bi directional exit points

Mod 116VA discriminates between bi directional and non bi directional exit points because sites that can enter flows can directly impact on exit flex overruns; exit users at these sites will potentially be exposed to an overrun charge irrespective of flowing flat or conversely, avoid overrun charges due to entry flows netting off 0600 hour - 2200 hour exit flow profiles.

Impact on Competition

CSL considers the proposal to be overly complex and therefore will act as a barrier to a new entrant.

Where DNs have access to diurnal storage facilities embedded within their networks, this Mod proposal prevents the selling on of this diurnal storage to other users through its

restrictions on capacity transfer. Under these proposals the DNs will maintain a monopoly hold on this storage which other class of users will not be able to gain access to.

Practicalities

We believe that there is the likelihood that at multi user sites the flex mechanism will be applied in a discriminatory manner. The flex allocation is dependent upon NGG NTS knowledge of each users flow up to 2200 and we fail to see how this can be imposed on facilities that operate arrangements outside the scope of the UNC who are generally not subject to the code. The Mod is lacking in detail on how this information will be obtained and does not consider the resulting implications on non code parties.

The Mod proposes that the aggregate IOPNS must equal the rates in the OPN. CSL understands that the current contractual arrangements at all offtake sites enable the user to nominate flow which is not constrained to the physical characteristics of that site. Therefore IOPNS and OPN rarely match. This situation is exacerbated at bi directional sites with concurrent inflow and outflow and is impracticable without the full co-operation of the facility operator who, as stated above, may not be governed by the UNC.

CSL believes that the IOPN mechanism for the allocation of flex capacity undermines the rest of the proposal until such a point at which capacity is constrained.

Operational Incidents i.e. trip event

If a large facility such as Rough or IUK has an operational incident such as a trip they have no choice but to cease flow and this trip occurs outside the 0600 – 2200 window, overrun charges may be levied. The amount of flexibility capacity required to cover such eventualities appears to exceed the available flex in the relevant zone.

For example if Rough, which flows at 24 mcm flat, trips at 22:00 will require 5.3 mcm flexibility whereas the total amount of flexibility proposed in Rough's zone (3) is 3.19.

Further, this will result in the grid becoming 8 mcm long and would expose Rough users to unlimited overrun cost if NGG use the buy back mechanism.

Under the current regime this situation would be dealt with as a national balancing action and possibly an entry capacity constraint at Easington. The flexibility capacity proposal of Mod 116V will not influence flows in this event but penalties would be imposed. There is no mechanism within the Mod to facilitate the mitigation of these costs and we worry that users may be incentivised to vent or flare gas to avoid punitive charges.

It is unclear when NGG would decide to use the flex mechanism or the balancing mechanism. Costs could be hidden in other mechanisms by NGG's choices or incentives as evidenced by its repeated refusal to release entry capacity (to avoid small risks) preventing users from balancing economically.

Auctions

Our analysis of the fundamentals of this mechanism suggests that, if the flex product is introduced, it will either be under subscribed and the price will be negligible or oversubscribed and capped by the cost providing alternative diurnal flex. NGG has indicated that the cost such alternatives to be around £20m /mcm.

In our view users will strive to protect themselves from flex overrun cost by the punitive overrun charges and this will lead to oversubscribed auction prices which may lead to inefficient investment to protect from this exposure.

In the event that capacity is physically limited then the mechanism will lead excessive costs either through buybacks or passed through to other mechanisms and markets.

The Mod suggests that an overrun agent be appointed to pick up overrun charges, we consider this impractical primarily because the agent (who in all likelihood would be a user) would need sight of other users (competitors) commercial positions to fulfil this roll.

Conclusions

CSL is unable to fully comment due to the Mod complexity and lack of clarity.

CSL believes that if there is no restriction there should be no charges. The Mod is unclear as to when an overrun charge will apply whether that be a limit of capacity sold or physical capacity which makes it difficult for users to quantify exposure and determine capacity prices.

The mechanism limits users ability to create and sell flex back into the system therefore prevents efficient provision of flex contra to the stated intention.

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;*

Whilst the introduction of a long-term capacity booking regime which is similar to that of Entry, may allow for the economic and efficient use of the system, CSL does not believe that the long-term commitment to a Flexibility product assists at all in this respect .

- (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;*

DNs are the only users able to influence flex use and will therefore be the only parties to gain from this mechanism, causing cross subsidy from other users.

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

Mod 116V is complicated, adds unnecessary admin costs to all users and NGG.

- (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*

Suppliers are unable to provide flex at entry points, discounts largest potential supply of flex on the system.

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

DNs are the only users able to influence flex use and will therefore be the only parties to gain from this mechanism, causing cross subsidy from other users.

- (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.

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

a) implications for operation of the System:

More costs and lower availability of balancing gas.

b) development and capital cost and operating cost implications:

Could cause inefficient investment signals

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

Costs should be bourn by the transporters and were included as a consideration of the DN sales.

d) analysis of the consequences (if any) this proposal would have on price regulation:

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 believe that the contractual risk of the transporter will be aided by implementation of these proposals.

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

CSL's storage systems will require a major rewrite to meet the significant contractual changes that would result from this mechanism. We estimate c£1m in total for CSL.

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

The majority of the storage services contract would need to be rewritten if flex was included. We estimate this to be in the region of 65 man days / yr.

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

Expectation that non code parties will administer allocation of charges, implications have not been considered.

Diurnal storage users ensure the safety of supply for domestic users, we therefore believe that its provision should be governed by safety law rather than artificial commercial incentives.

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

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

We have identified the following advantages:

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

We have identified the following disadvantages:

Please refer to preamble before relevant objectives section.

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.

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

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

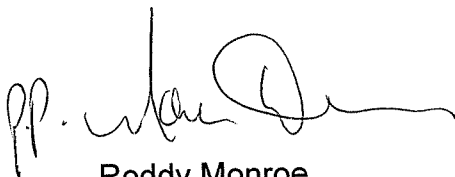
CSL expects that at least two years will be needed to incorporate flexibility into our contracts and system.

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

Further Comments

Please contact me if you require any further information.

Yours sincerely,



Roddy Monroe
Regulatory Manager