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Dear Julian,

Re: Modification Proposals 0116V/116VD/0116A/0116BV/0116CV: “Reform of the NTS Offtake Arrangements”

The Gas Storage Operators Group **does not support** the implementation of Modification Proposal 0116V

The Gas Storage Operators Group **does not support** the implementation of Modification Proposal 0116VD

The Gas Storage Operators Group **supports** the implementation of Modification Proposal 0116A

The Gas Storage Operators Group **does not support** the implementation of Modification Proposal 0116BV

The Gas Storage Operators Group **wishes to comment on** the implementation of Modification Proposal 0116CV

Amongst the Proposals which we believe, if implemented, would better facilitate the relevant objectives, we would rank the degree of facilitation in the following order (most favourable first):

1. Proposal 116 A would best facilitate the relevant objectives.
2. The Gas Storage Operators Group believes that Proposal 116 CV represents an improvement on 116V, 116VD and 116BV, but there are still areas which are not yet sufficiently clearly defined to enable Storage Users to properly evaluate the commercial and practical impacts of the proposal. Please see our detailed comments in section 5 below.
3. The Gas Storage Operators Group does not believe that Proposal 116V, 116VD or 116 BV would better facilitate the relevant objectives.

The Gas Storage Operators Group is a trade association which was formed in May 2006 within the SBGI (Society of British Gas Industries). The group has 12 members and comprises almost all the active participants in the GB Gas Storage Market, and as such represents a wide range of interests. The group includes both established operators and developers of new storage projects, large multinational companies and smaller private ventures. The current members of the group and signatories to this submission are detailed in the Appendix.

As the UKCS moves into decline and Great Britain becomes a net importer, Gas Storage has vital role to play in maintaining security of supply and supporting the efficient operation and development of the NTS System, as is widely acknowledged in the industry and promoted by government:-

“The UK economy faces a major challenge; our indigenous gas supplies are in decline and we are moving towards increasing dependence on gas. To manage this challenge, new gas supply infrastructure is needed to increase Great Britain’s capacity to import, store and transport gas efficiently. A regulatory environment that enables the development of timely and appropriately sited infrastructure projects is therefore vital.”

Ministerial Energy Statement of Need for Additional Gas Supply Infrastructure, 16th May 2006

“Facilitating the timely construction of sufficient storage [and gas import infrastructure] is [also] critical”

Government’s report on the Energy Review, 11th July 2006

“...we continue to believe that well-functioning markets are the most effective mechanism for ensuring adequate investment in gas infrastructure”

DTI Consultation on Security of Supply, 16th October 2006

Yet under these proposals, Storage Users face the prospect of higher costs and much greater complexity associated with Storage use, and potentially poorer access to storage services. This will devalue storage services and could potentially harm the development of the nascent (but urgently required) competitive market for storage in the UK.

The Gas Storage Operators Group therefore fails to understand why this (and other proposals which clearly add to the costs of Storage, such as Modification Proposal 120) are being proposed at this critical time when it is so clearly counter to the future energy needs of Great Britain to do so.

The group believes that the obligation on National Grid to introduce arrangements such as these should never have been included in the licence.

This response sets out our general views about the inapplicability of the proposed offtake reforms to Storage, and hence our main reasons for supporting 116A. It then provides some further specific points of objection to the application of all the proposals to Storage sites and our particular objections to the flexibility product. Finally it sets out our position with respect to proposal 116CV, before providing comments under the response proforma headings.

1. General Inapplicability to Storage Sites

- The interim arrangements at exit introduced the Flexibility capacity product to take account of the DNO's requirements for a daily offtake profile which supports the operation of their networks. The sale of flexibility in the NTS was intended primarily to facilitate the DN's in making efficient investment choices between the costs of NTS flexibility versus investment in LDZ interruptible contracts and/or in diurnal storage.
- Through industry discussions, it is generally understood that NTS exit points fall into 3 distinct categories i) DN's, ii) Direct Connects and iii) Storage and Interconnectors, generally grouped together as 'Bi-directional Sites'.

Storage (and other Bi-directional) sites operate in a different manner from DN's (and NTS direct connects), because Storage sites regularly flow in either direction and because they can stop flowing altogether whilst still serving the needs of their Storage customers.

Storage Operators will not make investment decisions based on the costs of flexibility from the NTS. Storage Operators do not therefore require, and would not respond to, incentives or investment signals related to the costs of NTS flexibility in the same way as DN's.

- Storage sites are currently designated as interruptible which to some extent reflects the bi-directional and counter-seasonal nature of storage operation. Introducing a requirement for Storage sites to purchase firm NTS exit capacity may provide misleading signals to National Grid for peak exit capacity requirements because Storage sites would not be operating as an exit point (injecting) on a peak day. This could lead to over-estimation of peak capacity requirements and consequently, inefficient investment by National Grid
- Further, many Storage Users and Operators have already provided investment signals through the entry capacity auctions and IECR process. The current proposals would not provide any further information than that already provided, and could mean that Storage Users would be asked to pay twice to provide the same signal of their requirements.
- Storage sites often provide benefit to the operation of the NTS, for example by supporting entry supplies (and hence network pressures) at times of peak demand. Yet costs to Storage Operators and Storage Users may be increased under these proposals whilst the benefits to the NTS go completely unacknowledged and unrecompensed

Storage is fundamentally, physically different from the DN's in its capability, mode and pattern of operation. Storage operation usually acts to reduce costs of operation NTS, and the presence of Storage may also serve to support efficient development of the NTS, for example by substituting for pipeline capacity. The net costs to National Grid to serve Storage sites must, by definition, differ from the costs to serve other NTS exit points. Storage also differs commercially from the DN's, as it operates in a competitive environment and under different licensing and exemption regimes.

Storage use of NTS flexibility is primarily driven by gas pricing which is driven by gas demand and system balancing requirements. DN use of NTS flexibility is driven by internal cost reduction and long term investment decisions. Storage will only use system flexibility on days of low demand when flexibility is plentiful. DN's will use flexibility on high demand days when its availability is limited.

Proposals Mod 116V, 116 VD and 116 BV would have different and disproportionate impacts on Storage compared to the DN's because of these differences.

In their Modification Proposal 116A, EOn UK argue that in circumstances where there are material differences between classes of User, application of non-discrimination provisions may be inappropriate and regulations **may not only permit but actually require** that material differences between classes of User be reflected in appropriately different treatment. It is only 'undue' discrimination which is prohibited.

The Storage Operators Group supports EOn's view, in that Storage is a materially different class of User from DNO's, and believes that Ofgem's intention to ensure no undue discrimination between DNO's and other classes of User on the NTS is inappropriate in these circumstances, which in fact call for 'due' discrimination.

1. Flat Capacity

Specific Problems for Storage Sites

1.1 Unfair Redistribution of Costs

The requirement for all NTS Users to book firm exit capacity is in effect a means of redistributing transmission costs onto currently interruptible supply points such as storage. Since the proposals do not alter the total exit capacity revenues to be recovered by National Grid, exit capacity income from Storage Users would substitute for income from currently firm NTS exit points, effectively creating a situation where Storage Users cross-subsidise non-Storage Users for use of the transmission system. NBP traders who don't use storage would be particularly advantaged under these arrangements.¹

Since investment in the NTS has never been made for interruptible supply points (and probably never would be), it is unfair to ask interruptible supply points to contribute to the costs of capacity which has not in fact been made available.

Further, since Storage Users would not be using transmission exit capacity on peak days, charges for exit capacity would not be cost reflective for Storage Users.

These arrangements will therefore disproportionately add to the costs of using storage services, which is unhelpful in this, the early stages of development of the competitive storage market in the UK. It also represents an unfair burden on Storage Users (and other interruptible supply points) relative to the rest of the shipping community, and increases the costs of maintaining security of supply to the Industry and the UK as a whole.

1.2 Flat Capacity - Allocation of Prevailing Rights

The Storage Operators Group believes that the proposed approach (116) to allocating prevailing rights will be completely ineffective at storage sites. Allocation on the basis of the sum of a User's maximum firm and interruptible exit capacity from gas year 05/06 does not provide a meaningful basis for allocation to Storage Users. This is because exit capacity at storage is currently entirely interruptible, and is not registered.

National Grid stated informally after the transmission Charging meeting in October that it would need to determine some alternative basis for allocations for Storage, for example actual flows on any given day in 05/06.

Storage Users tend to have highly variable patterns of flows, from season to season and year to year. The sum of storage users' daily requirements at a storage site will generally exceed the daily injection capacity, since not all storage users would be expected to flow on the same day.

Any allocation based on rights or usage of Storage from the gas year 05/06 would mean that the initial allocation of prevailing rights would be to those Storage Users who have made use of storage services during that gas year, even if only on one day, but who may then have no further immediate/subsequent need for the capacity. This could lead to Shippers being allocated rights they no longer require, and they would need to apply with 14 months notice to reduce them.

This could also lead to problems for other would-be Storage Users gaining access to Storage services, as the firm service would already have been allocated to those who happened to use it in the last year.

¹ Utilities who use storage and ship through the DN's would pay more for storage, but potentially less for exit capacity to the DN's

The application of UIOLI principles, such that sold but unused exit capacity is made available as D-1 interruptible capacity (as is proposed by 116) through a pay-as-bid auction, would enable storage users to obtain capacity on a daily basis. However there would be much less certainty that daily service would be available. Also, if overruns charge only apply when there is an aggregate overrun, it would leave very little incentive for Users to purchase capacity bi-laterally from the parties to whom it was originally allocated, which would seriously limit the development of any secondary trading.

Even with UIOLI in place, the proposals could lead to the sterilisation of firm exit capacity if the incumbent holder of capacity is unwilling to transfer it and the incoming user has to wait a number of years to obtain it from NGT. This would be a particularly difficult situation for new users of storage services.

Hence Storage Users appear to face the prospect of being allocated prevailing rights which are either inefficiently expensive for their actual requirements (ie: paying for a years worth of firm service to be sure that it is available on the occasional days it is required), or greatly reduced certainty that they can access Storage services at all, since some Users will have already been allocated the prevailing firm rights.

National Grid has acknowledged that the allocation of prevailing rights presents particular problems for Storage and that further work is required to develop this issue. However, at this point, there is insufficient clarity for Storage Users to properly assess the potential commercial and practical impact of these proposals.

1.3 Flat Capacity – Interruption and Buybacks

Historically, those exit points that have been designated interruptible have provided flexibility in the NTS and hence helped avoid unnecessary investment. Storage sites have not generally been interrupted for capacity reasons because they operate counter-seasonally (ie injecting in summer and acting as a system entry point in winter)

Removal of interruptible designation may discriminate unfairly against storage, because Storage Users will have to book firm to be certain of capacity, but will not have the opportunity to sell back capacity to National Grid NTS. This is because National Grid NTS are never likely to need to buy back exit capacity at storage sites, unlike those sites with which National Grid NTS will have negotiate bilaterally, to ensure they meet their 1 in 20 obligation.

Further, the Gas Storage Operators Group fails to see how any incentive on National Grid to buy back capacity from Storage could be constructed, since contracting for a service which would never be required could not possibly be economic or efficient for National Grid.

None of the Proposals provide sufficient clarity as to the way in which National Grid would choose amongst tools for system management, (in particular as to how National Grid can determine whether flexibility or flat capacity is to be bought back). Even excluding flexibility capacity, the rules surrounding the circumstances and mechanisms leading to buy-backs or other system management actions are of vital concern to Storage users who may face constraints at off-peak periods (eg summer injection periods). Without proper detail on the operations of these arrangements it is not possible for Storage Users to fully assess the commercial and practical impacts of these proposals.

The Group also believes that placing the details of these arrangements in the System Management Principles Statement is contributing unhelpfully to the fragmentation and dilution of the UNC.

1.4 Ineffective and Misleading Price Signals for exit capacity investment at Storage Sites.

National Grid has stated that it would not invest for flexibility capacity. The Storage Operators Group believes that this is appropriate and therefore does not see that the flexibility product is required for non-DN users at all.

The proposals in Mod 116V, 116VD, 116BV and 116CV will not facilitate effective investment signals for NTS exit capacity at Storage Sites. The auction of annual flat exit capacity cannot provide an accurate indication of peak requirements because storage peak requirements will not co-incide with transmission peaks and storage will be acting as an entry point on peak demand days. Consequently, auctions will over-estimate overall peak exit capacity requirements, and also, could not effectively signal the particular exit requirements associated with storage operation.

In order to obtain appropriate investment signals which relate accurately to the requirements of Storage sites, National Grid needs signals specifically for off-peak requirements (eg the degree of likely constraint in summer periods) and this is not provided for within the current proposals. An annual product does not provide for variations reflecting seasonality in Users requirements (and hence off peak requirements), and so auctions of these products could not, by definition, provide an indication of off-peak requirements.

Further, the application process for incremental flat capacity requires long term user commitments for firm capacity which are disproportionate to individual Storage Users requirements for Storage Services, and it is unlikely that any user would be able to make such a commitment.

Also, many Storage Users and Operators have already provided investment signals through the entry capacity auctions and IECR process. The current proposals would not provide any further information than that already provided, and could mean that Storage Users would be asked to pay twice to provide the same signal of their requirements.

Storage Operators therefore believe that the implementation of proposals 116V, 116VD 116BV and 116CV would not provide effective signals for overall investment in NTS exit capacity, and particularly so at Storage Sites. Implementation would result in either unnecessary investment or discrimination in the level of service provided by NGT. This therefore undermines a central objective of the implementation of these proposals.

General Problems with Flat Capacity

1.5 Flat Capacity – Loss of Interruptible tools for managing the NTS

As noted in the Modification Report, the removal of interruptible status means the removal of an effective existing tool for managing transportation constraints and demand which is vitally important in the context of a Network Gas Supply emergency.

The removal of interruptible status and the introduction of proposals for buy back incentives on National Grid reduces the incentive on end-users to install back-up, limiting the ability of the market to provide demand side response, and possibly limiting the effectiveness of any response to a Network Gas Supply Emergency.

Implementation of these proposals means that stages 2 and 3 of a Network Gas Supply emergency would be reached earlier than under the existing arrangements since there would be no interruptible loads to take off the system before looking towards firm load shedding. The changes in stages of an emergency being reached would change the way in which customers are taken off the system, potentially affecting security of supply for some large users.

2. Conclusions on Flat Capacity

The storage operators group therefore believes that the proposed rules associated with release of flat capacity:-

- result in an unfair distribution of transportation costs to Storage Users/Operators and other interruptible supply points
- would potentially hinder effective access to storage services, especially for new entrants
- discriminate unfairly against storage because Storage Users will not have the opportunity to sell back capacity to National Grid
- would create potentially misleading and ineffective overall investment signals, and particularly at Storage Sites
- could require Storage Users to pay twice to provide the same signal of their requirements, since many have already signalled requirements through entry capacity auctions
- would harm effective competition for storage services
- would result in additional costs for storage operators, many of whom are small players bringing projects to market which will benefit the market as a whole, and hence,
- increase the costs of maintaining security of supply
- potentially reduce the future availability of vital gas storage in the UK

3. Flexibility Capacity

Specific Problems for Storage Sites

3.1 Flexibility Capacity - Allocations and Gaming

Allocation of flexibility profiles at multiple-user, bi-directional sites is fundamentally inoperable. This is because it is possible for a flexibility capacity requirement to be generated by two separate storage users nominating against their flat capacity holdings in opposing directions. In this circumstance it is impossible to fairly allocate the flexibility capacity requirement to any one shipper, as it results solely from the presence of more than one party operating at the storage point. Although the modification proposals provide a number of options for allocating the charge, none of the options addresses this issue and they would all result in costs being unfairly applied.

Further, flexibility capacity charges generated in this way cannot conceivably be cost-reflective.

Under Mod 116VD there is potential for negative flexibility to be accommodated, which potentially offers discriminatory competitive advantage to Users at bi-directional sites, since they would be capable of purposely creating negative flexibility.

Whilst accommodation of negative flexibility would begin to take better account of the operation of Storage and other Bi-directional and Multi-User exit points, it would introduce significant further complexity in its own right associated with allocations and charging, would not solve the fundamental problem of fair allocation of a flexibility requirement, and could still not possibly be cost reflective.

Therefore the Storage Operators Group believes that the complexity and cost associated with the implementation of any flexibility product would still not be justified and so cannot support Mod 116VD, or any other proposal which includes the Flexibility product.

3.2 Contractual Issues

Storage services contracts are usually based upon the assumption of end of day allocation and balancing. Introduction of flexibility will introduce a within day allocation and nomination requirement. Significant contractual and system changes would be needed to accommodate these proposals. The Storage Operators Group estimates that at least two years would be needed to re-negotiate storage services contracts and build new systems to accommodate any proposal that involves flexibility.

General Problems with Flexibility Capacity

The group supports the general reservations against the flexibility product described by BGT in its proposal 116C. These are re-stated here from the perspective of the Storage Operators Group.

3.3 Investment signals

National Grid has stated that there would be no network investment for flexibility capacity. It follows that removal of the flexibility product would not detract from any objective of the original proposal to provide investment signals.

3.4 Quantification

National Grid has demonstrated that the quantity of flexibility available each day is dependent on a number of unpredictable factors and it is therefore impossible to forecast the long term quantities of flexibility available. This does not support the sale of a flexibility product to all users on a long term basis.

3.5 Artificial scarcity

National Grid has had to describe nodal, zonal and network limits on the amount of flexibility capacity available, limited to the lowest amount that National Grid can guarantee to provide at a future date. In reality flexibility is dependent on user requirements which are unlikely to co-incide and is widely understood to be unconstrained in practice, particularly given the current programme of NTS investment. This does not support the requirement for the transporter to enable unfettered access to system capacity as it creates artificial scarcity of the product.

3.6 Suboptimal assessment of system capability

As described above, the system capability would be under-estimated under these proposals

3.7 Absence of secondary trading/transfer

For those parties able to forecast more reliably their use of flexibility in advance, mainly DN's, this is likely to be for peak requirements across all days. It is likely that this would not be released to other users until there was certainty that it would not be required by the DN's 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 ie the original modification would place an artificial constraint on the system.

3.8 Exposure to overruns

At all locations where there are multiple users and where there are bi-directional flows it is possible that users may incur overrun penalties as a result of the actions of other users.

3.9 Contrary to EU Regulation 1775/2005 on conditions for access to gas transmission networks.

Storage Operators share BGT's view that the original proposals would hamper liquidity and trade across the IUK and Moffat Interconnectors, which is contrary to convergence with Europe and therefore working against the ambitions for a liberalised European Market. Storage Operators also agree that the proposals may prevent the unencumbered release of the full capacity potential of the network (article 5 (1))

Further, Storage Operators believe the proposals would hinder access to Storage and hence hamper the development of the competitive Storage market in the UK.

3.10 Extreme Complexity

All Users and Transporters would be required to establish and maintain sophisticated systems to manage flexibility and there is a lack of clarity about important aspects of the regime such as allocation of prevailing rights and the processes for selection of capacity management tools. These have the potential to profoundly affect the commercial impact of the proposals for Storage Users.

3.11 Exposure to Risk

Storage Users face high risks that they may not be able to acquire flexibility service, because it would be artificially limited and not released by other users in sufficient time to be useful.

3.12 High Costs for Users and Consumers

The necessity for complex systems will generate costs. The acquisition of flexibility will generate costs. Flexibility Overruns and the SO Commodity (flexibility) charge would also add costs.

3.13 Impact on other regimes

BGT state the case that power stations could be adversely affected by lack of available flexibility and that this could cut across the efficient operation of the power market.

Similarly for storage, lack of available flexibility capacity could hinder Users access to storage off-peak such that summer injection could not be accomplished, with consequent risks to delivery from storage at peak times. It would also harm the general development of the competitive storage market.

4. Conclusions on Flexibility Capacity

The Storage Operators Group therefore believes that the application of the flexibility product to storage sites:-

- is unnecessary
- is unworkable
- cannot be cost-reflective
- would create significant cost and complexity associated with storage use
- would consequently limit access to Storage services
- would add significant legal/contractual and system development costs to Storage Operators
- would therefore harm the development of the competitive market for storage

5. Position with respect to Mod 116CV

The Storage Operators Group has set out above the reasons why it supports Mod 116A, principally because it would enable appropriate differences in treatment between materially different classes of User to persist. We have also stated that we believe that flexibility capacity would be fundamentally inoperable at Storage Sites, and for this reason we cannot support any proposal to implement the flexibility product.

The Storage Operators Group recognises the significant effort invested by Ofgem, National Grid and the Industry in the development of the proposed reforms over the last two years. The group acknowledges that Mod 116CV is a pragmatic attempt to move forward with reforms whilst avoiding the unnecessary complexity of the flexibility product, and whilst introducing useful measures which would inform the longer term requirement for rationing and allocation of flexibility. It therefore represents an improvement over the proposals which incorporate the flexibility product, and would be the Group's second preference, after Mod 116A.

However as described above, there are still serious concerns for storage operators relating to the implementation of the rules for flat capacity, particularly relating to the allocation of prevailing rights, the rules surrounding buy-backs and the way in which investment signals are generated and interpreted. These issues may profoundly affect the commercial and practical impact for Storage Users, and much of this is, as yet, insufficiently clearly defined.

It is therefore not possible for the Storage Operators to support the implementation of Mod 116CV without its' further development to address these concerns.

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;*

Mod 116 A would best facilitate this objective, as it would enable DNO Users to register their requirements beyond September 2010, and allow National Grid to continue to consult and forecast other Users' NTS Exit Capacity requirements consistent with and pursuant to the relevant provisions in UNC Section O, which would allow National Grid NTS to undertake better informed investment decisions beyond 2010 and thereby facilitate the efficient and economic operation of the NTS pipeline system

Removal of interruptible supply point status will lead to more firm demand and reduce demand side response, adding to balancing costs on high demand days. Requiring storage exit points to buy firm capacity will result in ineffective investment signals and hinder the efficient use of off peak capacity.

- (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;*

Mod 116A would best facilitate this objective, by allowing DNO's and National Grid to confirm their requirements beyond September 2010.

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

Mod 116A would best facilitate the achievement of this objective, by allowing appropriate differences in treatment between materially different classes of user to persist.

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

- (i) *between relevant shippers;*

Mod 116 A would best facilitate this objective as it would continue to secure effective competition between Shippers without exposing them to ineffective competition with DNO's.

Mod 116A would also avoid the introduction of rules which could lead to problems accessing exit capacity at Storage Points and hence hinder effective competition between shippers.

- (ii) *between relevant suppliers; and/or*
No Comment

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

Mod 116 A would best facilitate this objective as it would avoid the introduction of rules which could artificially limit the amount of flexibility available for the DN's.

- (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*

Under these proposals (except 116A), costs for storage use would be increased, increasing the overall costs of security of supply to the Industry and hence the UK as a whole.

Mod 116A would best facilitate maintenance of domestic security of supply standards, by maintaining the interruptible user status and continuing to provide incentives for interruptible users to ensure they have stand-by fuel arrangements in place.

- (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.*

Placing the rules which define the mechanisms by which National Grid manage exit capacity constraints in the System Management Principles Statement would contribute unhelpfully to the fragmentation of the UNC and hence inefficiency in the implementation and administration of the UNC.

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

Removal of the right of Users to purchase Interruptible NTS capacity annually removes an effective existing tool for managing system constraints, and could quicken the onset of stage 2 or 3 Network Gas Supply Emergency.

The Storage Operators Group also supports the statement in National Grid's Modification Proposal 116/116V : "The added costs and complexity of operation were this Proposal to be implemented would have an adverse impact on incentives to invest in storage and hence would adversely impact security of supply."

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

a) implications for operation of the System:

The proposals (except 116A) can only add cost and complexity to the operation of the system, particularly in the daily administration of auctions and in administering systems for managing flexibility capacity, and then in translating these outcomes into how the system is operated.

It is not clear that there are any benefits of implementation which outweigh these burdens of costs and complexity.

There is insufficient information about the mechanisms by which National Grid would manage exit capacity constraints to enable proper evaluation of the impacts.

To date Storage has been able to offer particular benefits to National Grid by providing services in support of locational balancing requirements. Implementation of these proposals could limit the availability of such services, since Storage Users may have difficulty accessing Storage services through lack of available transmission exit capacity, or find it prohibitively expensive.

b) development and capital cost and operating cost implications:

Implementation would have associated costs implications which Ofgem are attempting to capture through their Impact Assessment. Modification 116CV would have lower costs of implementation than the proposals which include the flexibility product. Mod 116A would have the least cost of implementation.

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

The Storage Operators Group believes that the statement in the proposals that costs "which National Grid incur as a result of the implementation of this Proposal that are deemed to be in accordance with Network Sales requirements are not intended to be recovered from Users", is appropriate.

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

Proposal 116 A would not have any impact on price regulation. Proposal 116CV would minimise the impact, by removing the prospect of non-cost reflective charging for flexibility. Proposals 116V, 116VD and 116BV would introduce such non-cost reflective charging.

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

Implementation of the proposals (except 116A and 116CV) would artificially limit flexibility available for the DN operators, which must increase their contractual risks.

Ineffective mechanisms for providing investment signals for National Grid would lead to inefficient investment and hence increase their contractual risks.

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

Under Proposal 116V, 116VD and 116B there would be a requirement develop and maintain complex systems for managing flexibility capacity for multiple users, both at Industry and individual User/Operator level.

Proposal 116A would remove the requirement for systems development altogether.

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

Proposal 116A would minimise the administrative and operational costs, and level of contractual risk. Proposal 116CV would be the next least cost and least risk alternative.

The Storage Operators Group does not believe that the improvements intended by Proposal 116BV to enable users to passively manage their flexibility requirements would benefit Storage Users (or other Multi-User sites), as they would still need agencies or other arrangements to manage allocations of flexibility between Multiple Users.

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

The removal of interruptible status means that there will be reduced incentives for Consumers to install back-up systems, which could consequently limit the ability of the market to provide demand side response, and possibly limit the effectiveness of any response to a Network Gas Supply Emergency.

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

Storage services contracts are usually based upon the assumption of end of day allocation and balancing. Introduction of flexibility will introduce a within day allocation and nomination requirement. Significant contractual and system changes would be needed to accommodate these proposals. The Storage Operators Group estimates that at least two years would be needed to re-negotiate storage services contracts and build new systems to accommodate any proposal that involves flexibility.

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

We have identified the following advantages:

Proposal 116A would:

- Avoid inappropriate discrimination between materially different classes of User
- Provide the least cost solution with minimal further impact on the industry
- Enable DNO's to confirm their requirements with National Grid beyond 2010
- Avoid unnecessary costs and complexity

Proposal 116CV would:

- Introduce measures to further inform the requirement for rationing and allocation of flexibility

We have identified the following disadvantages:

None of the Proposals gives sufficient information or clarity in relation to:-

- Allocation of prevailing rights
- Mechanisms by which National Grid would manage Exit Capacity Constraints and the Rules surrounding buy backs
- The way in which investment signals are generated and interpreted to enable Storage Operators to properly evaluate the commercial and practical impact of these proposals.

Therefore we believe that all the Proposals (except 116A) would:-

- Result in an unfair distribution of transportation costs to Storage Users/Operators and other interruptible supply points
- Potentially hinder effective access to storage services, especially for new entrants
- Discriminate unfairly against storage because Storage Users will not have the opportunity to sell back capacity to National Grid
- Create potentially misleading and ineffective overall investment signals, and particularly at Storage Sites
- Require Storage Users to pay twice to provide the same signal of their requirements, since many have already signalled requirements through entry capacity auctions
- Harm effective competition for storage services
- Result in additional costs for storage operators, many of whom are small players bringing projects to market which will benefit the market as a whole, and hence,
- Increase the costs of maintaining security of supply
- Potentially reduce the future availability of vital gas storage in the UK

Further, Proposals 116V, 116VD, and Proposal 116BV introduce the Flexibility product for Non-DNO's which we believe is unnecessary and would:-

- Be unworkable
- Not be cost-reflective
- Have disproportionate impacts on Storage and Bi-directional sites
- Create significant cost and complexity associated with storage use
- Add significant legal/contractual and system development costs to Storage Operators
- Consequently limit access to Storage services
- Therefore harm the development of the competitive market for storage

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

The Storage Operators Group believes that the removal of interruptible supply point status would remove an effective tool for managing demand and transportation constraints, which consequently could quicken the onset of a Gas Supply Emergency.

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

No comment

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

See Below

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

The Storage Operators Group estimates that at least two years would be needed to re-negotiate storage services contracts and build new systems to accommodate any proposal that involves flexibility.

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

No Comment

Further Comments/Summary

Under these proposals, Storage Users face the prospect of higher costs and much greater complexity associated with Storage use, and potentially poorer access to storage services. This will devalue storage services and could potentially harm the development of the nascent (but urgently required) competitive market for storage in the UK.

The Gas Storage Operators Group therefore fails to understand why this (and other proposals which clearly add to the costs of Storage, such as Modification Proposal 120) are being proposed at this critical time when it is so clearly counter to the future energy needs of Great Britain to do so.

Storage is fundamentally, physically different from the DN's in its capability, mode and pattern of operation. Storage operation usually acts to reduce costs of operation NTS, and the presence of Storage may also serve to support efficient development of the NTS, for example by substituting for pipeline capacity. The net costs to National Grid to serve Storage sites must, by definition, differ from the costs to serve other NTS exit points. Storage also differs commercially from the DN's, as it operates in a competitive environment and under different licensing and exemption regimes.

The Storage Operators Group supports EOn's view, in that Storage is a materially different class of User from DNO's, and believes that Ofgem's intention to ensure no undue discrimination between DNO's and other classes of User on the NTS is inappropriate in these circumstances, which in fact call for 'due' discrimination.

Yours faithfully,

Adrian Fernando

Name : Adrian Fernando (Chairman)

Organisation : The Gas Storage Operators Group

Appendix 1

List of Members of the Gas Storage Operators Group

Canatxx Gas Storage Limited

Centrica Storage Limited

EdF Trading Gas Storage Limited

E.On UK Ltd

Ineos Enterprises

National Grid LNG Storage

Portland Gas Ltd

SSE Hornsea Limited

Star Energy Group

Statoil (UK) Limited

Warwick Energy

Wingas Storage UK Ltd