

Call for evidence on the use of the gas interconnectors on Great Britain's (GB's) borders and on possible barriers to trade.

A Response by Centrica

Question 1: What are your views on the economic efficiency of cross-border gas flows between GB, Belgium and the Netherlands? How important do you consider this review into cross-border flows to be?

Centrica in principle welcomes regulatory oversight of the operation of key EU Interconnection Points (IPs) to ensure any barriers to efficient gas trade are quickly removed. However, in the case of IUK and BBL we do not see any material problems with the current operation of these gas interconnectors by their respective network operators. Centrica believes there are some market distortions resulting from neighbouring network operators' (NNOs) tariff arrangements. We identify these and potential solutions in our answers to Questions 2 and 3.

Changes to the arrangements for the access to and use of IPs are envisaged in the European network codes and guidelines annexed to Regulation 715/2009. We expect that implementation of the planned European network codes and guidelines should further facilitate gas trade in NW Europe.

We believe that NW European National Regulatory Authorities (NRAs) should focus on delivering the efficient implementation of well drafted European network codes. This should include appropriate implementation by IUK and BBL, reflecting differences between dedicated gas interconnectors and national TSOs with multi-pipeline networks.

Question 2: What is your experience with cross-border gas trading between GB, the Netherlands and Belgium? What, if any, are the key barriers to economically efficient gas trades happening across our borders? Please provide any evidence or analysis that would contribute to our understanding of the observed behaviour of cross-border gas flows.

Centrica is active in cross-border trade at all three borders between GB, the Netherlands and Belgium (GB ↔ NL, GB ↔ BE and BE ↔ NL) and is a shipper in all networks covered by the call for evidence. We believe that the operation of IUK and BBL by their respective network operators has generally supported efficient gas flows.

The analysis in the open letter also appears to be overestimating the level of Flows Against Price Differentials because:

- The pricing data used (Bloomberg) in the open letter is not the best available. Price data from Heren and Spectron demonstrates a better alignment with flows.
- The analysis does not take full account of transmission costs. Transmission costs (both capacity and commodity charges) can significantly influence flow decisions. The GB TO Commodity charge in particular impacts flows, encouraging gas to flow away from the GB market.
- As noted by the European Commission's analysis, the FAPD tool only captures part of the market. It does not account for sales of medium to long-term gas products or flow decisions

made after the day-ahead market closes (e.g. to manage imbalance positions or trade within-day.)

Centrica believes that improvements could be made to address the following issues which could be impeding efficient gas trade across the GB gas interconnectors:

- 1) The GB TO Commodity charge acts as an incentive to divert gas away from the GB National Grid towards mainland Europe.
- 2) High short-term pricing for entry and exit in the Dutch TSO's (GTS) network reduces incentives for shippers to use BBL. In particular, although the allocation of BBL's interruptible reverse flow (IRF) product is designed to find a market price, the high cost of short term entry capacity charges at Julianadorp often exceed any basis between NBP and TTF making it uneconomic to flow gas.
- 3) Delays in implementing existing EU Energy Legislation by EU TSOs in general could be limiting the most efficient use of IUK and BBL.

Question 3: How could current market arrangements be improved so that they better promote the objectives of promoting a competitive internal market, eliminating restrictions on cross-border trade in gas and enhancing the integration of national markets as well as security of supply? In your response, please specifically refer to a) IUK, b)BBL, c) the adjacent market arrangements and d) whether more common arrangements are needed where relevant and possible.

IUK

We believe that IUK is operated in a manner that is consistent with promoting the objectives on a competitive internal market. The operation of IUK does not restrict cross-border trade in gas. IUK is supportive of shippers who engage in secondary market capacity trading.

For the purpose of implementing the Congestion Management Guidelines, IUK could look to speed up access to capacity for market participants that are not already IUK shippers. Potential shippers could be signed up with zero capacity, so that all contractual formalities and credit checks can be concluded and the new shippers will be better placed to access at short notice any capacity which is unused by existing shippers.

BBL

We believe that BBL is operated in a manner that is consistent with promoting the objectives on a competitive internal market. BBL is supportive of shippers who engage in secondary market capacity trading. We would like IRF auction results to be published.

The cost of short term firm BBL capacity can be expensive relative to annual capacity due to seasonal multipliers and premiums for very short term products. However, short-term capacity may also be available on the secondary market from existing shippers. The price of short-term capacity should not undermine the secondary market or incentives to book longer term, however the level of

premium the tariff formula creates to short-term products over and above an annual equivalent could be reduced.

As mentioned in response to Q2, high short-term pricing for entry and exit in the GTS network reduces incentives for shippers to use BBL. For backhaul entry at Julianadorp, GTS and the NMa should consider trialling lower tariffs as recently agreed for the auction pilot at OSZ GUD interconnection point where the NMa granted GTS the option to lower combined monthly and daily factors.

We would like clarity on how Ofgem and the NMa propose to implement certification of BBL as a TSO under the 3rd Package and how this could affect implementation of EU Gas Network Codes and Guidelines by BBL.

IUK & BBL – implementation of EU Gas Network Codes and Guidelines

For both IUK and BBL appropriate implementation of the EU Gas Network Codes and Guidelines that are currently being developed by ACER, ENTSOG and the European Commission should enhance shippers' ability to access and use the GB interconnectors efficiently.

In finalising the texts of the EU Codes and Guidelines and approving national implementation, EU authorities and NRAs must ensure that the resulting rules do not create inefficiencies that make it harder for market participants to use the GB interconnectors for cross-border gas trade. For the GB Interconnectors, some of the requirements of the EU Network Codes may not be appropriate, particularly where these have been based on the operation of large multi-pipeline national networks. In such specific cases, a more flexible interpretation of the relevant parts of the EU Network Codes should be possible. For example, it would not be appropriate to create a virtual hub in each interconnector.

Adjacent market arrangements – National Grid Gas

Gas will appear to flow against price differentials unless the GB "TO Commodity Charge" is taken into account. Zero and heavily discounted reserve prices for short term entry capacity in the National Grid network have led to significant under recovery as shippers are incentivised to book capacity short term. National Grid's entry capacity sales currently account for only c. 30% of allowed entry revenues, with the balance of 70% being recovered by a charge on entry flows – the TO Commodity Charge.

A growing proportion of gas supplies available to enter the GB market have a choice of destination. This applies in particular to gas landing at Bacton, where shippers can use IUK to access gas hubs in mainland NW Europe. The TO Commodity Charge is currently acting as a "tax" of around 1.5 pence/therm on landing gas into the GB market. If NBP prices are not more than 1.5 pence/therm above continental prices, market participants will be incentivised to send gas to continental hubs. We believe that these commodity charges are contributing to higher wholesale gas prices at the NBP which are feeding through to consumers' gas and electricity bills.

We believe this is a significant issue that needs urgently to be addressed in the GB market in order to achieve changes before any improvements that might result from an EU Network Code on gas tariffs. There are a number of generic options for change:

- Restructuring the commodity charge – various options including a two-tiered commodity charge (differentiated by whether customers have bought long-term capacity) and/or commodity charges differentiated by the entry-point.
- Capacity charge reform – e.g. removing the discounts offered on short-term capacity compared with long-term capacity costs.

Short haul tariffs should not be considered part of this problem. Short haul tariffs are a valuable tool supporting efficient use of networks. We believe short haul tariffs should be incorporated in the Tariffs Network Code as these avoid inefficient construction of pipelines.

Adjacent market arrangements – GTS

GTS uses a similar mechanism of seasonal and short-term premiums to BBL that can make short-term capacity prohibitively expensive, especially during the winter period. We would like to see these premiums reduced. On the other hand we do not recommend discounting short-term capacity where this could lead to problems with under-recover as in the GB and German markets.

In the design of the tariff mechanism for the next GTS regulatory period starting 2014, it is important that there is not any discrimination in setting exit charges for export flows, compared with exit charges for domestic consumption. Transmission tariffs should be reflective of efficiently incurred costs.

Adjacent market arrangements – Fluxys

Fluxys has recently introduced a new entry-exit system, which included creation of a new virtual hub in Belgium. Whilst the new system has been implemented relatively smoothly, we have concerns about the tariff costs to access the new hub ZTP, which may affect liquidity.

Are more common arrangements are needed where relevant and possible?

The level of harmonisation being targeted in the European Network Codes will continue to help improve the competitive gas market.

One benefit of this call for evidence and the stakeholder workshop is that market participants were able to discuss with all three National Regulators together their experiences with access to Interconnection Points (IPs). We believe it would be useful to have more stakeholder consultation in English covering implementation of the Network Codes across neighbouring Member States. Whilst NW European TSOs often consult their users and hold shipper meetings in English, consultation by the National Regulator is normally carried out in the national language. Given the international nature of gas trade we recommend that Regulators make available at least the executive summary of current consultations in English to help more market participants participate in the process.

Question 4: Should we try to proceed with minimum necessary changes or should the regulators be looking more holistically at a wider review of arrangements that may present barriers? Should we be considering piloting some deeper regional integration or joining initiatives that are already going on in Europe?

National Regulators should focus on implementing the EU Gas Network Codes and Guidelines resulting from the 3rd Package. We do not believe that implicit auctions or other forms of deeper regional integration are appropriate for the GB Interconnector IPs at this point.

Question 5: What process may help us to achieve the best outcome? What role should regulators, market parties and TSOs have in this process? How would it interact with pan-European policy initiatives?

As mentioned above we support continuation of the current processes that will lead to full implementation of the EU Gas Network Codes and Guidelines resulting from the 3rd Package. The GRI NW could be a useful platform to help early implementation of Network Code principles where appropriate.

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We hope you find this response useful. For any clarification please contact:

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