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Sonia Brown  
Director, Transportation  
Office of Gas and Electricity Markets

**By email**

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Dear Sonia

**National Grid Transco – Potential sale of gas distribution network business  
Initial thoughts on enduring incentive schemes supporting the offtake arrangements**

Centrica Storage Ltd (“CSL”) is the operator of the offshore Rough storage facility and processes Amethyst and other third party gas at the Easington entry terminal. The Rough exit point is located in close proximity to the current Easington sub terminals and the Ormen Lange site currently under construction. Over 35 shippers have signed the CSL Storage Services Contract that allows gas to be allocated by CSL at both the entry and exit points at Rough.

CSL offers the following comments on this consultation document. We consider our comments on the Transco consultation “Towards a New Industry Framework” remain valid and some comments here reiterate points in that earlier letter. This response is not commercially sensitive.

CSL does not object in principle to the prospective sale of DNs, and we accept that any sale is likely to present a positive NPV for end-users. However, CSL remains concerned that the enduring offtake arrangements are excessively complex and would, in particular, reduce the benefits to end-users by comparison with retaining indefinitely the proposed interim arrangements.

**a) Security of Supply**

The enduring proposals present particular adverse impacts for storage users and storage operators; these are especially undesirable given the effect on traded markets from untimely depletion of storage stocks in GB as illustrated during the current relatively mild winter.

From a storage perspective, any change to the exit or entry regime that discourages new storage build cannot be for the benefit of security of supply for GB.

The case for increased indigenous storage has never been stronger whilst the enduring proposals-

- would force counter seasonal loads to purchase firm capacity based on peak-load reserve prices even though these loads will provide a benefit to the market at peak
- would encourage shaped injection profiles in line with the prevailing market conditions to avoid allocation/cost sharing between the storage operator and users.

- would reduce the amount of UIOLI storage capacity available to the market at injection and conversely would reduce the amount of gas in or cycled through store
- would introduce levels of complexity and risk that could threaten maintenance of the storage monitors.

It cannot be in the nation's interest to pursue an exit regime that causes unnecessary cost and effort to fill storage inventories prior to the peak period (seasonal load) or to cycle gas (mid range storage). An ideal solution is an exit regime that places no regulatory or increased financial barriers to new storage entrants.

CSL believes the following proposals would represent a more efficient and effective solution -

- *Release of UIOLI at a day-ahead stage up to peak system capability.*
- *Rather than "annual" auctions, two basic exit capacity periods, a December-March "peak period" with April-November being the off-peak period.*
- *Setting over-run charges to a "default" level of zero from April to November for exit except where Transco can make "by exception" a case for a different treatment.*
- *Zero exit reserve prices will normally be appropriate at storage connection points and also at other nearby exit points other than at high demand levels, say 85% of forecast peak-day firm demand or higher.*
- *It would not be unduly discriminatory to adopt exchange rates that effectively allow storage shippers at storage nodes to move exit capacity to these locations during offpeak at zero cost.*
- *If required, flow flexibility rules need only apply on days of system stress/demand above a threshold.*
- *Long term auctions for flow flexibility seem unnecessary: and the product should be kept bundled with exit as it is a by-product of investing in primary system capacity.*
- *Allow users to flex offtakes within their NExA's and within the booked 'exit' product.*

## **b) Investment Signals**

Transco's new Ten Year Statement recognises that even after 2 years, "in relation to existing entry points, the [entry] auctions are still to provide us with clear signals that would justify investment above the baseline adopted for [the] present price control". Consequently the industry should be concerned that so much of the existing offtake proposals are being driven by a desire to replicate the entry model at exit, where as there is actually no evidence of helpful investment signals. An auction at entry could be seen as an allocative solution where multiple bidders compete at a limited number of entry points in effect to supply a market (NBP), but over 80% of NTS offtake points will only have a single bidder for capacity at that point.

Likewise, over a field life (say 10 years +) a producer is driven by field profiles and a willingness to lock in the right to provide the NBP with a product through an entry terminal that has limited substitutability.

At exit, most locations other than DN's have a much shorter horizon of certainty. I&C sites will typically sign 1 to 2 year contracts with shippers (suppliers) being uncertain as to diurnal profiles of the end users; CCGTs cannot possibly predict flexibility requirements reliability in a market with so much price and regulatory uncertainty; and storage sites do not know how firm injection rights are distributed between users until close to the gas day and storage users have historically shown a desire to book services less than 3 years out.

Much of the demand has been catered for given small domestic growth, and it is extremely unlikely that Transco will either receive sufficient signals from existing locations or identify the need to reinforce exit capacity even if sufficient nodal areas in a zone signal a prolonged intent to purchase exit capacity.

### **c) UIOLI Exit Capacity**

At present storage users can get interruptible exit rights at storage connection points, and generally do so and thus pay no exit charges. This cannot involve undue discrimination, since storage users will normally be withdrawing from storage and entering gas into the NTS on days when Transco might wish to interrupt exit flows and thus on days when exit capacity should have real value.

As storage shippers currently utilise interruptible capacity, we consider UIOLI provisions are of critical importance in maintaining consistency of approach to existing commercial arrangements in the enduring regime. CSL favors release of UIOLI at a day-ahead stage up to peak system capability. Given the benefits afforded to the NTS by storage sites we recommend that zero exit reserve prices are normally appropriate at storage connection points and also at other nearby exit points other than at high demand levels, for UIOLI exit capacity say 85% of forecast peak-day firm demand.

Transco suggest the amount of capacity available on a UIOLI interruptible basis would be a function of capacity sold in the long to medium term. This runs counter to the fundamental tenet behind UIOLI, namely that available unused capacity whether “booked or not” should be available to those who can and would use it. Restricting UIOLI below the physical maximum available would merely imply permitting hoarding by the transporter.

We appreciate that restricting UIOLI capacity would put some added focus on annual and longer-term capacity. However this again appears to ignore the fundamental point that costs are best focused on the exit requirements creating the marginal demand i.e. at peak periods. There is no industry-wide benefit in this concept. The current arrangements are simply more efficient.

### **d) Flow Flexibility Product (“FFP”)**

CSL’s main concerns regarding the FFP relate to

- FFP applicable on days with no system stress
- allocating this aggregate charge on multiple shippers across bi-directional meter points
- shippers unable to know/forecast the FFP charge within the gas day and having no input into how the storage operator plans physical flows
- the risk that the FFP may encourage back-profiled injection rates, which would reduce the potential availability of UIOLI storage capacity

CSL accepts that DNOs (by their sheer size i.e. 80% of NTS offtake) need to have some incentive to discourage them from imposing all their swing requirements on the NTS and thereby avoiding capital or revenue expenditure of providing their own swing where this would be cheaper overall. In these circumstances we envisage that the FFP may be appropriate, should Ofgem consider the existing licence obligations not provide the necessary safeguards.

It seems appropriate to consider the circumstances in which Transco should be able to charge for flexibility inherent in the system. Setting a low reserve price for a given level of national flexibility is meaningless if a commodity charge is then to be applied onto the product. The current price control supported a range, with or without the provision of summer flexibility for winter and summer, ranging between 12 and 50 mcm of swing potential. We do not consider that an annual (averaged) linepack flex level (30 mcm) is appropriate or that peak and offpeak provisions need to be pursued if the FFP is deemed necessary by Transco.

We believe that Transco and Ofgem must take full account of the benefits that physical swing providers bring to the NTS. This swing enables shippers, with Transco acting as the residual balancer, to match supply/demand on the system. Whilst understanding that Transco need to ensure that the DNOs and retained DNs do not make inefficient investment decisions for the

provision of diurnal storage, applying a FFP charge to every NTS off-take point will have unintended and undesirable consequences on the operation of both gas and power markets.

Our conclusion is that there is at present no purpose or benefit from a long term auction for flow flexibility and that the product should normally be kept bundled with exit capacity rights as it is a by-product of investing in primary system capacity. We do not accept that Transco should require shippers' offtaking gas to buy 'flexibility' whilst deliveries of gas continue based on end of day capacity holdings. This is in no way an endorsement of similar proposals for entry, rather a plea for Transco to allow users to flex offtakes within NExA's and within the booked 'exit' product.

### **1. Appropriate methodology to be used in defining baselines for both NTS exit capacity, and NTS exit flow flexibility**

Given the massive difference between winter and summer demands, we do not think that it is efficient or appropriate to introduce a system which implicitly requires similar effort for exit capacity throughout the year. We recognize that annual capacity will be available, but "exit economics" fundamentally should focus on winter balancing and requirements, and the approach considered to date have failed to adopt such a focus. Without any seasonal shape to long term auctions, it is unlikely that any storage shipper will indicate a willingness to secure long term firm exit rights at storage sites.

We therefore recommend splitting the year into "peak" and "off-peak" periods. Rather than "annual" auctions there could be two basic exit capacity periods, a December-March "peak period" with April-November being the off-peak period. Rather than doubling the workload, because most locations' capacity should have no value in the off-peak period requirement in the off-peak, this should enable users to concentrate on the key periods and locations.

All existing storage facilities are counter seasonal site(s) operating through an interruptible offtake point. Transco have a vested interest in ensuring storage customers are able to stock their inventories before the peak months. It is neither inappropriate or unduly discriminatory to impose a base line price of zero outside the December to March period at storage sites. We envisage that Transco would in exceptional circumstances define summer constraint areas and amend baselines accordingly such that capacity management tools could be meaningful and relevant.

Naturally, shippers at storage sites should pay for exit capacity for injections during peak periods if the vast majority of stock can be injected into store offpeak at close to zero cost. The peak pricing of exit capacity we purpose handles the "flight from firm" that must be of obvious concern to Transco when 80% of NTS nodal points are not competitive.

### **2. Whether baselines should be defined as a constant, or whether these should increase over time**

Transco's "Transporting Britain's Energy" indicates that growth in demand up to 2013 is likely to be about 1.4% p.a. There will therefore be little need to reinforce for growth. We are therefore naturally concerned that arrangements for NTS exit are being progressed at pace, with Undertakings requiring 'best endeavours' to deliver these arrangements by September 2005.

### **3. The indicative baseline numbers provided by Transco**

Firstly, we agree that Transco should be incentivised to release the maximum existing NTS exit capacity on the network and we would like to see this capacity completely de-coupled from any reinforcement needed to accommodate growth in sales. If the system has spare capacity on the day, the incentive regime should encourage this capacity to be released.

Specifically regarding exit capacity for Rough. CSL agree the firm exit quantity at Rough is 0 GWh/d as the site is currently an interruptible load. However, the Firm + Interruptible level should be 220 GWh/d to mirror the Storage Connection Agreement, which in turn reflects the approximate maximum amount of Rough injections available at low reservoir levels.

CSL doesn't understand how the 1284.2 GWh/d figure is derived (Practical Max Physical), but we do not object to the stated amount. We have repeatedly informed Transco that storage shippers will not buy flat annual firm exit capacity at Rough for a number of reasons. The industry need comfort that storage shippers can access exit capacity so that storage inventories are stocked prior to the winter. CSL maintains that interruptible exit capacity should be made available at the day-ahead stage up to network physical capability. Given the surplus of supply at this exit point and the benefits to the system afforded by storage sites in general, CSL would expect this price to be zero.

#### **4. The proposed treatment of substitution (exchange rates) and investment as part of the enduring incentive schemes**

CSL consider the exchange rate principles to be unduly complex and likely to confuse the nodal to zonal distinctions. The exchange rate principle can effectively be replaced by a requirement on Transco to provide for unconstrained [offpeak] system capacity release at day ahead stage based on physical capability.

The benefits counter seasonal loads bring to the community has been completely disregarded by these proposals. Storage sites enhance exit capacity by providing additional exit capacity on days when the system requires such capacity. CSL therefore considers it would not be unduly discriminatory to provide for exchange rates that effectively allow storage shippers at these nodes to move exit capacity to these locations during offpeak at zero cost. This would then enable shippers to efficiently optimize their portfolio, e.g. inject more gas into store using exit capacity from a different node should demand patterns not be as initially considered else where on the network.

#### **5. The proposed approach to the setting of UCAs for NTS offtake points**

Except for new connections to the NTS, it is difficult to envisage a requirement for the UCA's to be configured for 170 NTS exit points during this summer. New loads connecting to the system are a slightly different proposition and CSL would expect the existing shallow reinforcement charge to be coupled with a reconfiguration of the network around that point in line with existing arrangements.

#### **e) Summary**

CSL notes Transco have suggested interim arrangements that require DNs and Direct Connect customers only to request additional flow flexibility from Transco above that allowed in the NExA. CSL considers this to be a far better solution for the enduring regime that would maintain some consistency with the current regime whilst allowing all NTS offtakers the opportunity to value flows above their current contractual requirements, with these valuations reflecting the tighter supply/demand situation brought about during periods of higher demand. This would be a low cost solution, benefiting the community and ultimately end-users without the need for immediate and rushed development before any auctions could be held this summer for a regime starting in 2008.

As evidenced in recent weeks, risk and cost do not suppress wholesale traded commodity prices. CSL considers that the existing enduring exit proposals could add significant pressures to the electricity market and balancing mechanism and could add to volatility in summer SMPs prices at a time when the British summer gas market looks set to be extremely long as flat-profiled new supplies become available.

Whilst accepting that similar classes of users should ideally be treated the same (storage users; interconnector and CCGT shippers) it is not clear whether it is necessary to treat all alike, especially given their different offtake profiles in terms of shape, size and impact on local linepack. This can better be addressed through a summer transfer rate to storage sites set at zero or robust UIOLI arrangements based on offpeak physical capability of the system at zero price.

Simply, CSL considers that storage and interconnector sites face undue discrimination from the proposed amendments to the offtake arrangements when considered against the status quo. At a time when security of supply requires a stable regulatory and commercial framework for accurate due diligence into projects to provide new storage and interconnectors, this is not in the interests of the industry or of gas users in general.

Please contact me should you wish to discuss further.

Yours sincerely

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