

Mr. Bogdan Kowalewicz
Gas Transmission
Ofgem
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London
SW1P 3GE

22 May 2009

Dear Bogdan,

RE: Proposed disposal of part of NTS for Carbon Capture and Storage

This response, sent on behalf of the Centrica group of companies excluding Centrica Storage Limited, is intended as a high level response to this first consultation on the subject of use of the NTS for CCS purposes. To this end, we do not respond in detail to all of the questions posed by the consultation document.

Background

Centrica has worked hard to develop an enviable standing in respect of its green credentials, and recognises the contribution that innovation has played in this success. As part of our desire to see a low carbon future, we recognise that Carbon Capture and Storage (CCS) is likely to play a very important role, but also recognise the significant challenges – both technical and economic – that any move towards CCS will bring. We therefore regard this innovative proposal by National Grid Gas (NGG) to dispose of part of the NTS for subsequent use for CO₂ transportation with great interest.

Chapter 2; Proposal to dispose of assets for CO₂ transportation

Question 1: *Do you think this proposal is a good idea in principle?*

In trying to decide whether or not we could support such a move, we are mindful of the extent to which we are entirely dependent upon the data provided by National Grid, as set out in the consultation document. Critical data in this respect include expectations of future gas flows through St Fergus, compressor usage/costs, and the extent to which decommissioning part of the NTS which serves St Fergus will impact upon these factors.

Our initial view is that the data presented within the consultation document in respect of future gas flow prediction looks reasonable. However, we were concerned by comments made at the recent National Grid CCS workshops by some participants that the figures may significantly understate future gas flow expectations. Given that once decommissioned it is impractical to return the pipeline in question to use

for gas transportation, it is clearly essential that it is definitively identified as redundant. We would not wish to be in a position whereby new NTS capacity has to be created at St Fergus – whether by investment or capacity substitution – to make up a shortfall which results from removal of this section of the NTS from NGG's regulated asset base.

There is also the question of the impacts of the loss of this section of pipeline on NTS linepack/flexibility. There are ongoing discussions about the role of the NTS in providing within day flexibility to balance variances between gas inputs and offtakes, and it seems evident that any reduction in pipeline volume will result in a lessening of the NTS's ability to cater for within day input vs offtake fluctuations. We would therefore be extremely concerned if this proposal resulted in, or brought forward, within day balancing constraints or flexibility tools to manage within day balancing. This is especially concerning with the increasing challenges faced by intermittency of wind generation, and the probable requirement for thermal gas CCGT plant to respond rapidly, which will require significant NTS flexibility.

By facilitating greater use of coal for power generation, we believe that this proposal could give rise to greater security of supply across the electricity network, which we would view as a positive step. Therefore, in principle we could be supportive but retain some reservations which we would seek to address through further consultations.

There are also a number of practical considerations. We assume that the intention is for the pipeline to be used for transfer of carbon to depleted offshore gas fields. It has not yet been identified how much generation will be able to connect and where. If it's only in Scotland - is it commercially and technically viable to build large scale coal generation in these areas? Otherwise, what other infrastructure would be needed to connect the source?

Question 2: *In the event that a feeder section is removed, existing compressors may be required to work harder to transport the same volumes of gas through fewer pipes. It is proposed to capture these additional compressor fuel costs and to introduce a capped volume for these additional fuel costs, based on pre-disposal levels, over which the new CO2 transportation business would bear the costs and make payment to NGG. What is your view of this proposed treatment of these additional compressor fuel costs?*

We agree that NTS Users must not face any cost increase if this proposal goes ahead. When assessing use of compressors, again we consider that we are only able to make a judgement based upon data released by National Grid. To this end, we would welcome an independent audit which should help to inform Users and also Ofgem of the extent to which additional compression has been employed post feeder decommissioning.

Chapter 3; Regulatory Issues

Question 1: *Do you agree with our view of the regulatory issues of the proposed asset disposal?*

We are acutely aware of the magnitude of the environmental challenges facing society, and the role that Ofgem/government is required to play in helping to achieve the necessary CO2 cuts by 2020 and 2050 respectively. We believe that innovative approaches such as this are essential if we are to achieve those targets.

Alongside this, we agree that it is necessary to balance the needs of gas consumers. Issues at stake are security of supply (i.e. ensuring that existing and new sources of gas are not shut out of the network, or unwittingly encouraged to land elsewhere due to insufficient capacity). We are also concerned for commodity prices, should capacity shortfalls arise due to NTS decommissioning.

As set out above, we were concerned to learn that some stakeholders believe that National Grid's TYS data may understate future gas flowing through St Fergus. We would therefore like to see new analysis taking full account of any such predictions. It may also be worth considering the likelihood of new LNG supplies coming in through St Fergus.

Question 2: *Do you agree with the projected forecast flows at St. Fergus?*

See above.

Question 3: *Are there other flow forecasts or scenarios which should be taken into account?*

As set out above, there may be potentially higher Norwegian flows and the potential for new LNG. We would also be concerned to ensure that full account is taken of the potential for West of Shetland gas developments, and the need to ensure that sufficient capacity remains at St Fergus without incremental investment being required, to accommodate all possible future supplies.

Question 4: *What is your view of the indicated capability at St. Fergus with the feeder removed, with and without additional compression?*

We are entirely dependent upon the data provided by National Grid. Based upon that data, we agree that the analysis put forward appears reasonable, but are in no position to challenge either the underlying data or the results of analysis based upon it. We believe that there could be a role for an independent audit to provide additional confidence around these figures.

Question 5: *What is your view of the projected buyback costs which have been identified?*

As above, we are dependent upon the National Grid data in arriving at any view. However, we are also mindful of the recent, extensive buy-back costs (millions of pounds) incurred over a matter of days when maintenance overran on an associated feeder. We assume that experience has been taken into account?

Question 6: *Are there any other issues that you believe are relevant?*

Although it has been the subject of significant discussion, as yet there is no agreed model for capacity substitution. It is therefore not clear how and to what extent capacity substitution could impact upon current entry capacity baselines. This adds further uncertainty to any questions around the effects of decommissions part of the NTS.

While we note the assurances around the preservation of entry capacity baselines, we are also mindful of Ofgem's comments during the baseline reconciliation exercise of 2008, where it was stated that baselines were never intended to be set in perpetuity, and could be subject to change particularly during a price control process. We note that the commencement of this proposed CCS project would be in 2013 – this being after the scheduled start for any TPCR5 agreement.

We have commented in the past that moves to "tighten" the NTS (e.g. capacity substitution), and similarly any reluctance to remove potential constraints (e.g. socialising of costs in relation to a gas treatment facility at Bacton), could have significant commodity price implications. These have the potential to dwarf any transportation cost savings made (or in the case of this CCS proposal, the opportunity cost from the use of the NTS assets for other purposes). We would therefore urge serious consideration to be given to the risk of commodity cost spikes from shutting out future gas supplies, e.g. new Norwegian or West of Shetland gas.

Whilst we welcome innovative thinking which aims to tackle the issue of carbon emissions, it is somewhat concerning that this development is being proposed against a background of no formal economic regulation for CCS activities, and no competitive process from which to drive true price discovery. Rather, this is a regulated monopoly seeking to transfer assets into an associated unregulated monopoly entity. That said we also accept that National Grid is in a unique position in respect of skills and asset ownership, and it would seem a shame to delay any potential benefits from this proposal, or indeed incur unnecessary additional cost, simply for the purposes of establishing a formal regulatory regime, or a competitive CCS market structure.

At this stage we do not have any additional suggestions about how to proceed, other than to urge caution in respect of protecting consumers and users of the NTS. We consider that one way of doing this would be through the use of rigorous external audit of costs and activities.

Question 7: *What is your view of the proposed disposal of these assets?*

In principle we could support disposal, and are particularly mindful of the environmental benefits such a move could bring with it, but we remain to be convinced that of the robustness of the analysis on the operational impacts on the NTS.

Chapter 4; Valuation of Assets

Question 1: *Do you agree with the possible ranges of valuations for the assets which have been identified?*

The range put forward – £0.2m to £182m is clearly extremely wide, and hints at the difficulty in setting an accurate value for these assets. We cannot provide any additional thinking to either support these figures, or to suggest that they are flawed.

Question 2: *Do you agree with the assumptions which underpin the asset valuations?*

We do not have any additional insight to either support or challenge these assumptions.

Question 3: *Is there an alternative method of asset valuation which should be considered?*

An alternative could be price discovery through disposal of the assets to a third party by means of a fully competitive sales/tender process, which would also require a much more clear distinction between the businesses.

Question 4: *Do you agree with the assessment of benefits associated with asset disposal and alternative use?*

To an extent, however we would not like such a fundamental decision to be either unduly rushed, or the asset value understated, in order that this proposal can fit in with the CCS competition timetable and economic case.

Question 5: *Are there any other considerations that should be taken into account?*

We are mindful that whatever method is used to value these assets will establish a strong precedent for any future disposals, either associated with CCS or indeed for any other reason. We would therefore urge very careful consideration of a range of other possible transporter disposals to ensure that as far as a possible a common methodology can be uniformly applied in the future.

Chapter 5; Commercial options

Question 1: *Do you consider that the opportunity to potentially share in the benefits of CCS using ex NTS assets represents an appropriate balance of risk and reward?*

We believe that there could be merit in a reward sharing approach. However, as yet we are unable to fully commit to such concept. Our decision will depend in part on the outcome of the additional analysis that we have suggested is necessary.

Question 2: *What is your view of a lump sum payment, in the event that consent is granted for disposal?*

Providing we can be comfortable with a valuation, this approach represents the simplest solution; effectively a clean break. We believe that for a number of parties this could be the preferred option, allowing them to concentrate on their core business of gas shipping. However, given the difficulties of asset valuation, a clean break lump sum payment stands a good chance of not returning an accurate compensation figure.

Question 3: *What is your view of a participatory royalty arrangement, in the event that consent is granted for disposal?*

Again, we re open minded to this approach, but of the three it is our least preferred option. Factors against it include difficulties in being able to accurately quantify and manage risks, and a pull away from our core business.

We look forward to working with Ofgem, National Grid and other shippers to develop suitable solutions to allow this proposal to proceed.

Please contact me if you would like to discuss this response

Yours sincerely,

Chris Wright
Commercial Manager