

Mr. Bogdan Kowalewicz
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1 December 2009

Dear Bogdan,

RE: Gas Entry Capacity Substitution Methodology – Initial Impact Assessment

Thank you for the opportunity to comment on the above mentioned Initial Impact Assessment. This brief, non-confidential response is sent on behalf of the Centrica Group of companies, excluding Centrica Storage Limited.

Centrica remains broadly supportive of the initial concept of entry substitution, particularly against a background of reducing UKCS output. However, we believe that that initial concept has become somewhat contaminated over time.

Centrica is disappointed both by the process through which substitution has been developed, and at the (apparently) chosen outcome of that process. We believe a number of facets of the “retainer” option are flawed, and believe that better options exist. Indeed, we consider that more appropriate options have already been developed by the industry, with a strong likelihood that these can be further improved upon. It is therefore our intention to push for a re-opening of the substitution methodology debate in the new year, possibly once the industry has been exposed to one “retainer” based QSEC auction.

We are also somewhat surprised at the brevity with which Ofgem dismisses the issue of wholesale market prices, both in terms of volatility and sustained increases, were substitution to remove capacity from where it is needed. Our recollection is that this single point caused the most concern amongst shippers during development discussions, yet warrants only two paragraphs in the Ofgem RIA. Our reading is that rather than conducting any analysis of its own into the impacts, Ofgem has side stepped the issue by concluding that this is not an issue because no-one has produced evidence to Ofgem of the scale of the problem. Such an approach does seem to rather negate the need for any regulatory impact assessments. Further, as far as we are aware, Ofgem has never formally asked industry parties to quantify the risk.

It is also worth emphasising the asymmetry of risk of having too small an NTS. Too little capacity on the system gives National Grid and consumers a high level of risk from constraints, leading to high market prices, and even security of supply issues, but at lower capacity cost. Too much capacity on the system gives National Grid and consumers a low level of risk from constraints but at higher cost, which is potentially recovered through TO entry commodity charges. In summary, we believe that the cost to consumers of having a small amount of “spare” capacity is much less than the likely impact of unwittingly creating a constraint when the market needs the supplies. Again, we are disappointed at the lack of analysis undertaken in consideration of this point.

While there is evidence to suggest that at the present time, in aggregate, there is too much capacity compared with the volume of gas available, the extent to which this is true, and is likely to hold true in future, varies between ASEPs. It is these finer points that we (and many others) believed could be addressed through use of a “mechanical approach” which required intervention in order to assess the risk and benefits of individual substitutions. The retainer approach requires shippers to try and assess the likelihood of an incremental signal being received, and also their exposure to substitution resulting from that signal, ahead of any auction. There is a high probability that at some point, a shipper or shippers will guess wrongly with unintended consequences.

A further concern we harbour is regarding the potential for the “commercial” NTS to shrink over time. There are two elements here. The first is simply a function of moving capacity at up to 3:1 (and possibly increasing over time). This in itself has the potential to drive wholesale price increases and volatility, and is therefore concerning, but seems to have been accepted as a necessary by-product of introducing a process that will tighten the NTS.

The second, and slightly more concerning, is that without proper regulatory oversight National Grid may not be providing the best possible outcomes for shippers in respect to individual substitutions. Indeed, it could be argued that National Grid may unintentionally select specific methodologies, or make detailed decisions in relation to specific substitutions that have the effect of retaining network capacity, thereby altering National Grid’s risk balance. We believe that Ofgem should commit to undertake detailed audits of each and every substitution in order to avoid National Grid being exposed to any such suspicion.

Please don’t hesitate to contact me if you have any queries in relation to this response, and we look forward to Ofgem follow up to this initial impact assessment.

Yours sincerely,

Chris Wright
Commercial Manager