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Dear Hannah,

**Re: Centrica Storage Limited's response to Ofgem Consultation on strategy for the next transmission price control (ref. 159/10)**

Centrica Storage Limited (CSL) welcomes the opportunity to participate in the consultation process for RIIO-T1. This document is a non-confidential response to Ofgem overview paper on RIIO-T1 strategy (ref. 159/10).

CSL is the operator of the Rough storage facility and thus, we interact with the Transmission System Operator (TSO) as a shipper, withdrawing and injecting gas into the National Transmission System (NTS) at the relevant exit point and entry zone. We are pleased to provide comments and suggestions to improve the regulatory framework under which the TSO will manage the gas network.

Overall, we believe the proposed strategy identifies the necessary outputs to be delivered, proper incentives to achieve them efficiently and robust mechanisms to adjust them for uncertainties. However, we have concerns over the framework ability to achieve the proposed objectives under special circumstances.

Following the structure of the consultation's overview paper, we would like to offer comments on the following issues:

1. review process and timetable (chapter 1)
2. outputs and incentives (chapter 4)
3. uncertainty mechanisms (chapter 6)

**1. Review Process and Timetable**

We expect Ofgem to set a timeline for RIIO which is consistent with the timing of TransmiT project. We believe that Ofgem's conclusions on TransmiT will be essential to properly define the RIIO primary outputs in regard to the conditions for connection. We recognise that clear output definitions should be included in RIIO strategy in order to give guidance to networks companies on the objectives to be addressed in their business plans. However, we note that Ofgem intends to publish the RIIO final strategy documentation in March and that the TransmiT review will not be concluded till the end of summer. Given this time inconsistency, we suggest that Ofgem should adopt a broad definition of the output on connection arrangements, which will be suitable for any additional conclusion will result from the TransmiT review.

## **2. Outputs and incentives**

One of the suggested output categories in respect of the gas network are the **reliability and availability** of the NTS. Ofgem suggests that the compliance with current obligations, as set out in the Gas Act, in GT license and in the UNC, will be sufficient to ensure the TSO will achieve the primary output, i.e. conveying the required volume of gas in a reliable and efficient manner.

We support this UNC compliance-based approach because we believe a number of issues have been efficiently resolved in the past through the UNC Modification Panel process. However, due to the very technical nature of some modification proposals, in order to ensure the compliance with UNC relevant objectives, Ofgem will need the technical ability to review these proposals or employ external auditors who can fulfil this function.

The entry/exit capacity substitution process is an example where the mimicking of TSO's technical reasoning is required before any proposed substitution is implemented : understanding whether the proposed substitution would occur at an efficient exchange rate is critical for reaching the conclusion that TSO compliance with this license obligation has effectively improved the reliability of the network in an efficient manner (RIIO primary output).

A second output category we wish to comment on regards the **conditions for connection**. We support the Ofgem proposal that the primary output should measure the timely and efficient delivery of new connections. We also support the compliance-based approach as a method of measurement. However, we believe that the current license obligations do not include time and cost-efficiency thresholds. We understand time limits are set upon the release of Entry and Exit Incremental Capacity; however there is no time limit for completing both the design and construction work of the physical connection. Likewise, we do not see any explicit incentive to minimise the cost of these works. We therefore suggest Ofgem make clear that these costs will be subject to the upfront efficiency incentive, as set out for capacity charges.

Moreover, we understand that current connection and capacity application processes do not effectively suit the requirements of bi-directional points. We understand the Gas Storage Operator Group is currently developing a proposal in response of the TransmiT project which aims to facilitate the overall application process for these particular connections. As already stated, we expect Ofgem to include into the definition of the "conditions for connection" primary output the coming conclusions from TransmiT review.

## **3. Uncertainty mechanisms**

Amongst the many proposed mechanisms to manage uncertainty over the regulatory period, we support Ofgem's proposal to **index the cost of debt** component of the allowed return. However, we expected Ofgem to provide a clearer explanation of the interactions between different proposed elements of RIIO strategy, as we stated in our response (dated 6<sup>th</sup> September 2010) to the consultation on RPI-X@20 Recommendations.

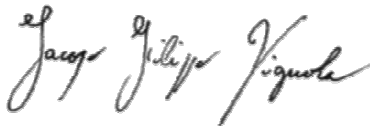
Our concern regards the interaction between the suggested long-term indexation of the cost of debt and the suggested application of an upfront efficiency incentive rate to all actual expenditures (TOTEX). We are concerned that the volatility of the short-term market cost of debt, when it diverges from the long-term trailing average, may

affect the effectiveness of the upfront efficiency incentive by creating a perverse incentive to over/under-invest, similar to the one which the current proposal aims to solve<sup>1</sup>. In both the consultation overview document and annexes, we did not find evidence that the proposed changes to the calculation of actual allowed revenues (i.e. the use of TOTEX, a fixed RAV addition rate and an efficiency incentive rate) do not affect the justification for a long-term indexation of the cost of debt. We therefore expect further details on this issue in the final decision document of RIIO strategy.

In conclusion, we believe the proposed strategy for the next Gas Transmission Price Control Review has the overall potential to set a sustainable regulatory framework, although further discussion is necessary on some aspects.

We hope that you have found these comments useful and please do not hesitate to contact us if you wish to discuss the response further.

Your sincerely,



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<sup>1</sup> RIIO-T1 and GD1 Consultation 159/10, Supplementary Annex on Financial Issues, §7.3