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Dear Bogdan

Proposed disposal of part of NTS for Carbon Capture and Storage - Second consultation and initial impact assessment.

National Grid welcomes the opportunity to respond to Ofgem's consultation and initial regulatory impact assessment on the proposed disposal of part of the NTS for Carbon Capture and Storage (Ofgem Reference 56/10). This response is on behalf of National Grid Gas and is not confidential.

National Grid Gas (NGG) owns and operates the National Transmission System comprising some 7,000km of high pressure gas pipelines, compressors, and ancillary plant. In addition it owns and operates four of the eight gas distribution networks.

We agree with Ofgem that CCS is a potentially important technology which may help secure the government's climate change targets and contribute to security of supply. We support the proposed disposal and NGG plans to shortly submit a formal request for consent to dispose of the feeder to the Authority based on the current proposal (while taking into account any relevant points that emerge from responses to this consultation process). We set out below a number of points in relation to Ofgem's consultation document. However, given that the consultation is on an NGG proposal and the questions are directed primarily at industry stakeholders we have not responded to the individual questions.

National Grid Carbon is a wholly owned subsidiary of National Grid plc formed in February 2009 for the purpose of developing CO2 transportation services for the developing Carbon Capture and Storage industry. National Grid Carbon is participating in the ScottishPower consortium engaged in the DECC CCS Demonstration Project Competition. The DECC CCS competition is designed to demonstrate commercial scale post-combustion CCS in the UK starting by 2014. The key objective of the competition is to provide an early demonstration of CCS for least cost.

The Gas Act places obligations on NGG in various respects including the obligation "*to develop and maintain an efficient and economical pipe-line system for the conveyance of gas*" (*Gas Act Section 9(1)(a)*). Normally this obligation is considered in relation to the development of new network infrastructure, however NGG considers that it is just as important in relation to parts of the network for which there is declining future need.

NGG identified that its network in Scotland was likely to have spare capacity in future years as a result of the forecast decline in gas to be landed at St Fergus. It spent considerable time and resource in analysing the implications of the proposed feeder disposal on the capability of the remaining network

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and the basis on which re-use of the feeder might be possible. This also included developing an understanding of the requirements of the CCS industry and CO2 transportation in particular to ensure that the released feeder would represent an economic option for CO2 transportation. This innovative proposal allows gas consumers to realise value for what is otherwise likely to become an underutilised asset.

Nation Grid plc takes its wider corporate responsibilities very seriously and it has internal corporate targets to reduce greenhouse gas emissions by 80% by 2050. We have also set an interim target of 45% by 2020 and to help measure our progress and during 2009/10 we will implement carbon budgets setting a maximum level of greenhouse emissions per business per financial year. In view of our internal goals, National Grid has taken on a leadership and advocacy role in this and other related areas by working with governments in the UK and US with a focus on expanded utilisation of energy efficiency, climate change legislation, expansion and efficient utilisation of transmission networks in connecting renewables, and renewable gas. Our involvement in CCS reflects our desire to take a leading role in addressing the longer term issues facing the energy industry including climate change and security of supply.

We trust you find the comments helpful, if you have any questions regarding any of the points made or require further information then please contact Andy Balkwill, Regulatory Policy Manager, NGG in the first instance.

Yours sincerely

by e-mail

Andy Balkwill
Regulatory Policy Manager
National Grid Gas

Proposed disposal of part of NTS for Carbon Capture and Storage - Second consultation and initial impact assessment: National Grid Gas Response.

Attachment

1) Chapter 2: We accept that the disposal would be on the basis of no detriment to consumers and that conditions would be imposed to protect consumers from avoiding the risk of detriment. The NGG proposal therefore involves:
   a) The entry capacity baseline at St Fergus being maintained
   b) National Grid Carbon taking on the liability for entry capacity buyback and from increased operational costs (e.g. compressor fuel usage) from operating the network with the feeder removed

   It is important to recognise that in taking on these risks, National Grid Carbon is providing a hedge against the uncertain level of these costs and this will allow the CO2 transportation tariff to be set independently of them. In the event that these costs are lower than forecast then National Grid Carbon should retain a share of the upside (otherwise the risks it faces are totally asymmetric) however NGG takes that some of the benefit of low buyback costs should be shared with gas customers.

2) Ofgem's duties are addressed in Section 2.4: "…The Authority must when carrying out those functions have regard to:
   - The need to secure that, so far as it is economical to meet them, all reasonable demands in Great Britain for gas conveyed through pipes are met;
   - The need to secure that all reasonable demands for electricity are met;
   - The need to secure that licence holders are able to finance the activities which are the subject of obligations on them;
   - The need to contribute to the achievement of sustainable development; and
   - The interests of individuals who are disabled or chronically sick, of pensionable age, with low incomes, or residing in rural areas…."

3) We believe that the work undertaken by NGG and in relation for forecast flows at St Fergus and the capability of the NTS which has subsequently been endorsed by independent work undertaken by Wood Mackenzie and Pöyry (on behalf of National Grid Carbon) demonstrates that the first of the above bullets can be met.

4) Successful development of CCS technology will make coal viable as a future low carbon fuel. As a result it will decrease the UK's reliance on imported gas, increase fuel diversity, and so contribute to security of supply. This addresses both the second and fourth bullets.

5) We agree with the Ofgem comments made in 2.13 regarding the important role of the Authority in bringing about an energy system that encourages substantial carbon reductions.

6) In Chapter 5 Ofgem note the significant number of responses to its April 2009 Consultation. We consider that National Grid Carbon (working with NGG) has addressed the points made through commissioning independent analysis (now published on the Ofgem website) and has addressed the points raised by respondents and Ofgem through the modified proposal which is the subject of this consultation. We agree that the most difficult issue is probably that of determining a fair valuation. NGG set out three options in late 2008 to Ofgem who consulted on these in April 2009. There was no clear preference from the industry respondents for any of the methods which produced widely differing values.

7) The latest NGG proposal (made to Ofgem on 5 February 2010) seeks to address the concerns raised and provide consumers with a value that will ultimately be determined by how successful the feeder is in its new role as a CO2 pipeline. It therefore acts as a proxy for a market valuation. For the reasons explained in the Consultation NGG considered an auction or similar approach would not be likely to be in consumers' interests in this instance. NGG remains of the view that with National Grid Carbon as part of the Scottish CCS consortium there is no other credible potential purchaser. When NGG submitted its revised proposal to Ofgem in February 2010 we stated that no third parties had expressed interest in acquiring the feeder and this remains the case to date. However NGG recognises that if in future other assets are identified for potential

disposal and if there is the possibility of realistic competition for re-use of such assets then a market based approach such as an auction might be an appropriate mechanism for determining the value. Ultimately it will be for NGG to demonstrate to Ofgem that any disposal of regulated assets has been undertaken on an economic and efficient basis.

8) In paragraph 5.28 Ofgem request the industry (shippers) to share their investment plans with Ofgem so as to inform Ofgem's understanding of the potential future need for the feeder in gas use. It should be remembered that the St Fergus baseline is being maintained. While NGG understands that shippers may not wish to share confidential information with the industry National Grid has concerns regarding the use of such information and the weight that should be attached to it. The industry has established an entry capacity regime based on user commitment and Ofgem has always emphasised the importance of user commitments being the basis for investment. Indeed in Ofgem's Final Proposals for TPCR4 they partially disallowed NGG investments that had taken place in the absence of appropriate user commitment (see 6.4 - 6.6 or TPCR4 Final Proposals).

9) A shipper might make confidential representations to Ofgem regarding future investment plans but in the absence of any user commitment we believe such representations should carry little if any weight.

10) Incentives to innovate: In paragraph 5.32 Ofgem refer to NGG's views on the importance of having the right incentives to encourage innovation. NGG agrees that innovation and risk taking need to be rewarded. Regulated companies will have no incentive to innovate where the benefits of successful innovation will all flow immediately to consumers while the costs of investigating opportunities that ultimately are not successfully developed lie with shareholders because the risk we face is totally asymmetric. NGG's activities in seeking to develop innovative uses for its assets are undertaken in accordance with its Licence[1] in relation to de minimis activities.

11) Ofgem suggest that because some funds for assessing the impact of CO2 on NTS assets were provided under the Innovation Funding Initiative (IFI) then this should prevent any other reward for innovation flowing to NGG. This appears arbitrary and if this principle is held to then if could create a disincentive to innovate. The IFI only provided 80% of the funding (the remainder coming form NGG) and the approach proposed by Ofgem implies that no consideration would be taken of other development work undertaken by NGG (i.e. the approach seems to assume that the entirety of development costs is funded through the IFI).

12) The IFI funding has allowed NGG to undertake non-project specific research and development that will facilitate CCS in general by confirming that NTS feeder assets are suitable for re-use in CO2 transportation. While this result is clearly of benefit in relation to the potential disposal of the Scottish Feeder it also provides more general benefit in relation to other possible sections of the NTS that might be identified as surplus in future. Furthermore, it is incorrect to imply that the IFI funding was for assets that were "…no longer required for gas transportation…". The IFI funding did not cover the network analysis undertaken to determine that the feeder could be released from gas service and NGG's case for disposal has not yet been accepted by the Authority.

13) In this case, the IFI funding has provided non-project specific knowledge regarding the suitability for NTS infrastructure for carrying CO2. The IFI was used to help NGG determine whether assets on the NTS can be re-used. In so doing this should help NGG to maximise value from disposal for existing customers. Subsequent costs (post Feb 2009) around research and development, including the independent supply forecast and network capability analysis, have been borne by National Grid Carbon at no risk to gas customers.

14) NGG agrees that the scope for there to be number of parties interested in acquiring the feeder is very limited (paragraph 5.36). This is principally due to the nature of the asset being considered for disposal and its possible alternative uses being limited together with the liabilities that sit with the asset (buyback etc). Some respondents have suggested that there might be other parties interested in developing a CO2 network utilising this asset. However National Grid Carbon is a

[1] Standard Special Condition A36: Restriction on Activity and Financial Ring Fence

member of the Scottish CCS consortium and Longannet is the largest CO2 emitter so that NGG remains of the view that there is no realistic chance of there being competitors for the feeder and so seeking non-binding expressions of interest at this stage would serve no purpose. As noted above, NGG recognises that going forward there may be other elements of NTS infrastructure that might identified as surplus. Some form of open season process could be considered for determining what value different parties might place on such assets for use in CO2 transportation.

15) We welcome Ofgem's agreement that the proposal that we presented (one-off transfer value plus a share of the future revenues) is the most sensible option.

16) We do not share Ofgem's initial view that an estimate of the RAV value should be used (5.40). The RAV has no linkage with physical assets. It was set when the industry was restructured at a level that would ensure (given the RAV / WACC revenue model used by Ofgas and continued by Ofgem) that Transco was able to earn sufficient revenue. Since it was set it has been adjusted for the addition of new assets, depreciation of pre-vesting assets and written down by Ofgem following the MMC investigation in 2003. Given the above, we consider that inferring a "RAV value" would serve no useful purpose - i.e. the number derived (and we are not clear how one could be derived) would have little meaning. National Grid Gas remains of the view that in the absence of a true market valuation that a proxy based on the revenue that can be earned from the new use provides the best method for determining the value of the feeder.

17) In paragraph 5.41 Ofgem note "…At this stage, the structure of the tariff which the consortium will be able to secure during the DECC programme and the way in which this will vary as a result of additional customers using the feeder to transport CO2 is unclear…" and NGG agrees with this. The structure of the proposal is based on NGG's discussions with National Grid Carbon who (based on their own discussion with DECC and the Consortium) take the view that a fixed £/T tariff will be required for shipping CO2 (this is on the basis that the CCS competition is designed to try to get participants to narrowly define their costs and does not envisage arrangements that would allow cost pass through. As a result National Grid Carbon has taken the view that it must offer DECC/the consortium a "hedge" against the uncertain cost elements associated with the pipeline – principally buyback and CFU (but the principle could be extended to other uncertain areas). The NGG proposal has been based on National Grid Carbon's assumptions of the likely structure of the CO2 tariff which could in turn be dependent on the manner by with the CCS levy is disbursed. In the event that these assumptions are different (e.g. through providing for some element of pass through of buyback costs) then NGG recognises that the impact and potential benefit of the disposal of the feeder for gas customers could be altered and that it would therefore be appropriate to revise the terms of the disposal so that the benefits to consumers outlined in NGG's proposal (5 February 2010) are broadly preserved. NGG would therefore anticipate that in the event that the Authority were to make a "…minded to approve disposal…" decision that it would be conditional on (amongst other things) clarification over the CCS levy arrangements and the CO2 tariff structure