

Lewis Hodgart
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Ofgem
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11 March 2011

Dear Lewis,

RE – Gas Transmission Exit Capacity Substitution and Revision Methodology – Initial Impact Assessment

Introduction and Summary

British Gas Trading is pleased to provide this response to the consultation. This response is on behalf of the Centrica Group of companies excluding Centrica Storage.

Overall, we support the introduction of the proposed substitution and revision methodology since there is a likelihood that some efficiency savings will be made as a result of it being put into action. Continuous review and oversight by Ofgem will help the industry to better understand those benefits and the suitability of the methodology over time.

To a very great extent the industry will rely on the assessments and network modelling made by National Grid Gas in the application of the methodology, the full detail of which, without additional measures, will not be transparent. Ofgem will have a significant role to play in approving or rejecting proposals made by National Grid in pursuance of the methodology and we would encourage Ofgem to scrutinise these proposals in great detail, including a detailed assessment of the actual network modelling performed. This will provide system users' with some confidence that substitution and revision decisions are likely to be made in accordance with the relevant requirements of National Grid Gas's licence but we would prefer specific obligations or incentives placed on National Grid to require this.

British Gas Trading has fully participated in the development workgroups leading to the current proposal by National Grid Gas. We have also responded to National Grid Gas's informal and formal consultations. Whilst some of the issues we, and others, have raised have been incorporated in the proposed methodology, there remain a number of items that still require further consideration and we trust that Ofgem will give close attention to these when the methodology comes up for review. The main issues for us are:

1. The lead time for release of exit capacity following the release of entry capacity is very long and subject to actual gas flows matching the increased capacity level over a two year period – the combination of long lead times for the release of entry and exit capacity along with the gas flow requirement could seriously undermine the efficient release of additional exit capacity and lead to sub-optimal investment by National Grid. This is a highly risk-adverse approach.
2. The application of the substitution methodology is limited to signals for capacity that correspond with investment lead times. We consider this to be highly limiting. In our opinion substitution should be applicable to ad hoc applications for enduring NTS exit (flat) capacity available over shorter timeframes (i.e. less than 38 months) so that unused capacity can be efficiently accessed. The key factor is a user's willingness to incur a 4-year user commitment. We believe that such a user should have greater entitlement to capacity than users at potential donor exit points who might rely on short-term capacity products to meet their needs. Otherwise, signals to National Grid Gas for long-term capacity will become distorted.
3. Generally, we are concerned about transparency of process and transparency on the availability of "technical" capacity. As things stand, we will be relying on Ofgem to rigorously assess and test National Grid Gas's modelling assumptions and techniques. However, we believe National Grid should have specific licence obligations (or "output measures") to openly demonstrate both compliance with the methodology and the adoption of a reasonable set of assumptions underpinning it (e.g. assumptions made on gas flows and availability of spare capacity). Following any analysis of substitutability we would expect National Grid to publish a report explaining in detail its analysis, assumptions and conclusions. The licence obligations should track performance over time and have the ability to detect and/or correct the methodology or key assumptions should it be shown that (a) potential substitutions and value are being unnecessarily denied (for example due to overly cautious gas flow forecasts) or (b) poor analysis has led to inappropriate substitutions taking place.

Response to Consultation Questions

Chapter 3

Question 1: Are there additional aspects of the methodology that should be highlighted?

The main principles of the methodology have been adequately summarised.

Question 2: Are the scenarios analysed appropriate and relevant to system development? If not, why not?

The 2 scenarios analysed are useful illustrative examples of how the substitution methodology might be applied. Of key importance, as described in the South East example, is the supply flow assumptions made by National Grid in assessing substitutability. As with the release of additional exit capacity following signals for new entry capacity, National Grid can be expected to take a very conservative view, relying on recent "proven" historical trends to inform future gas flows. This could lead to sub-optimal decisions, decisions that should be informed at least by central case forecasts of future supply patterns.

Chapter 4

Question 1: Do you agree with our assessment of the methodology (within the framework of the current licence)?

In all probability the methodology will be seen to provide benefits, via the avoidance of some investment costs, to system users and consumers. However, a likely conservative approach by National Grid in its assumptions around available capacity and gas flows, and the lack of transparency around the detail of the actual analysis, may actually withhold potential benefits. It would therefore be helpful if National Grid were further incentivised to release incremental exit capacity efficiently via substitution. For example, if through a retrospective assessment of the application of the methodology it is found that National Grid's assumptions were too conservative, leading to high levels of unnecessary investment, then some of that unnecessary investment cost should not be passed on to system users and ultimately consumers.

Question 2: Are there any quantitative benefits that have not been included in our assessment?

As mentioned above, we are concerned that the methodology in its current form will provide only limited benefits. If, as expected, National Grid will tend to underestimate gas flows and, as stated, significantly delay the release of exit capacity through its revision methodology, then significant benefits may not be realised.

We also believe that restricting substitution to marry with investment lead times provides for a sub-optimal process in relation to Ad Hoc applications for capacity – capacity that could be provided through substitution in the shorter term will be denied to the applicant, even though the applicant will, in progressing the application, be signalling a willingness to take on board the 4-year User Commitment. As a result, significant projects (new connections or substantial upgrades to existing off-takes such as power stations) could be unnecessarily delayed and in the meantime the potentially substitutable capacity at the donor points might remain unused.

In the same vein, unused capacity at potential donor points is not being sought by National Grid: there could arise scenarios where a user at a potential donor point might be willing to release capacity there for substitution but is constrained from doing so by having some residual User Commitment attached to it. National Grid might be able to efficiently substitute such capacity but unfortunately this does not form part of the proposed methodology and is a missed opportunity.

Question 3: Are there any qualitative benefits that have not been included in our assessment?

As before, the limitations of the proposed methodology that we have highlighted will negatively impact on the qualitative benefits that have been identified.

Question 4: Are there any quantitative costs that have not been included in our assessment?

Depending on the level of scrutiny that will be given to National Grid's analysis, we would expect Ofgem to incur some cost in assessing National Grid's proposals.

Question 5: Are there any qualitative costs that have not been included in our assessment?

Implementation of the proposed substitution methodology could provide more uncertainty to those wanting to apply for capacity via the Ad Hoc process, particularly between the months of October and December (i.e. a period during which it is possible that National Grid may still be assessing substitution options following the last July application window) since such applications may be delayed/ subjugated to July window applications that might be competing for the same capacity via substitution. Any added delay in National Grid responding to an Ad Hoc request would add uncertainty for the applicant and possibly result in deferred investment decisions. Arguably, such uncertainty could give rise to costs for

the applicant. However, we understand the motivation to avoid tactical Ad Hoc requests blocking potential substitutions.

If you would like to discuss this response or any other related matter, I'm happy for you to contact me directly.

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Yours sincerely,

Graham Jack
Commercial Manager