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Dear James,

**Re: Centrica Storage Limited response to Ofgem's Consultation on determining revenue drivers for South East exit capacity (ref. 183/11)**

Centrica Storage Limited (CSL) welcomes the opportunity to respond to this consultation and provide comments on the setting of new revenue drivers for Incremental Exit Capacity in the South East area. This is a non confidential response and as such we have no objection to it being placed on Ofgem's website.

CSL would like to provide comments on the following aspects of the setting process:

1. modelling approach and assumptions
2. cost estimation
3. generic revenue driver methodology

**1. Modelling approach and assumptions**

CSL generally agrees with NGG's proposed approach of introducing a separate on/off revenue driver to meet potential offtake demand at storage sites.

In particular, we believe that NGG should plan, and be remunerated for, the necessary reinforcements to the NTS, taking into account forecast of demand at the new relevant Exit Point. In the case of storage facilities, the technical capacity determines the maximum injection rate into the reservoir and, in turn, the maximum demand that can occur at the relevant Storage Exit Point. This approach is also consistent with the principles of the European 3<sup>rd</sup> Energy Package<sup>1</sup>.

By the nature itself of a storage facility<sup>2</sup>, it is impossible that the maximum injection capability is used everyday throughout the year. The actual number of days and the pattern of these when the maximum injection capability is used – and an equal demand for NTS offtakes occurs – depends on the nominations received by the storage operator from his customers. Although an initial assessment of duration and rate of the injection phase(s) can be derived by the storage profile of the reservoir and its technical characteristics, it should be noted that the actual injection flow can only be determined day-ahead or within-day depending on the nominations received. In

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<sup>1</sup> The 3<sup>rd</sup> Energy Package obliges the Transmission System Operator to “assess market demand when planning new investments”, as specified in article 16(5) of EC Regulation 715/2009.

<sup>2</sup> a storage facility is designed to inject gas into a reservoir so that the same amount can be withdrawn later on, when market demands for additional supply. It follows that some days gas is off-taken from the NTS (injection phase) and some other days gas is supplied to the NTS (withdraw phase).

fact, customers nominations depend on the commercial strategy they apply to the actual market conditions. For example, a shipper covering his exposure to a long position may decide to inject the extra gas into a storage reservoir; therefore, the relevant decision to buy both Storage and NTS Exit Capacity would occur on a very short-term basis (day-ahead or within-day).

The above reasoning highlights the need to plan the NTS such to sustain the maximum injection rate of the storage facility, although bookings for the relevant Exit Capacity may occur at different points in time. This approach is also consistent with the principles of the European 3<sup>rd</sup> Energy Package<sup>3</sup>.

While CSL believes that the 400 mcm/day level is a reasonable proxy for the demand level under which storage facilities with fast-cycle capability could operate<sup>4</sup>, we do not believe that bookings for evergreen firm capacity as equal to the maximum injection capability should be expected with long-term advance notice<sup>5</sup>.

Regarding the other assumptions made to model the physical network, CSL does not believe that the increase in gas supply necessary to meet the increased demand in the South East area should be assumed to come from supply side in the north of the country. Once it has been assumed that it is unlikely that injection in storage occurs on peak demand days, it is likely that increasing supply will come from the near Bacton terminal, where UKCS sites would benefit from keeping constant their production rate by supplying storage injections.

## **2. Cost estimation**

CSL finds it difficult to provide comments on the cost of the reinforcement, since the relevant information has not been disclosed in the consultation document. Whilst we appreciate that such information may be sensitive ahead of the work commissioning, further transparency at least on the nature of the expected costs would have helped to understand the cost estimation process at this stage of consultation. We rely on Ofgem considering whether the auditing by an external consultant is the right approach to ensure that the proposed costs accurately reflect NGG business as usual and do not make for excessive gold-plating of current assets to sustain the additional demand.

The use of the same *unit cost assumptions* as in RIIO-T1 submission seems reasonable, thus it will reflect the same methodology as to be used for further network investments in the next future.

CSL agrees that NGG should be incentivised to seek a contractual solution, where feasible, to meet the additional demand. However, it should be noted that the NTS will need to accommodate a more volatile pattern of supplies and offtakes resulting from more diversified and less predictable supply sources and an increased interruptible demand of additional gas-fired power stations (in support of the intermittency of wind power generation). We believe that only through continuous modelling of supply/demand forecast and resulting network flows it will be possible to assess the feasibility of potential cost savings through contractual solutions instead of asset investments. Therefore, we agree with the Ofgem proposal of being prepared to

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<sup>3</sup> The 3<sup>rd</sup> Energy Package obliges the Transmission System Operator to maximise the availability of capacity, viewed as the most efficient mix of services (e.g. firm and interruptible) to satisfy user demand, as specified in article 14 and 16 of EC Regulation 715/2009

<sup>4</sup> as Ofgem proposal, §3.28 (first part)

<sup>5</sup> as Ofgem proposal, §3.28 (second part)

modify the Licence to adjust the values downwards in the event that contractual solutions occur.

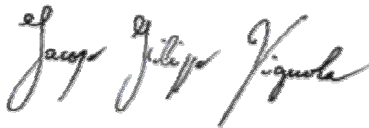
### **3. Generic revenue drivers**

CSL believes that further arrangements should be included into the UNC to define a sustainable governance framework that deals with all aspects of the connection process, including the necessary steps to trigger an Ofgem process for the setting of new revenue drivers<sup>6</sup>. Since we understand that a dedicated sub-workgroup of the UNC Transmission Workstream will start working soon on this issue, we suggest that Ofgem works in parallel on the methodology for generic revenue drivers in the RIIO-T1 period, so that the overall arrangements can be constructed consistently.

In conclusion, we believe that Ofgem should allow NGG to recover additional revenues that would cover it for the cost of the necessary NTS reinforcement to support the maximum offtake rate that can occur at the relevant Storage Exit Point.

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

Your sincerely,



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<sup>6</sup> CSL view is in line with the suggestions provided by the Gas Storage Operators Group (GSOG) in its response to Ofgem “Initial assessment of RIIO-T1 business plans and proportionate treatment”.