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16 March 2007

Dear Bob,

**Re Notice under section 23(3) of the Gas Act 1986 – Revised Baselines for System Entry Capacity**

Thank you for the opportunity to comment on the amendment to the Entry Baselines within the Transporter Licence, proposed under section 23(3) of the Gas Act 1986.

We recognise that this process is an element required in concluding the Price Control Review for 2007- 2012 and implementing the consequent changes to the licence drafting to bring this into effect.

In this respect we acknowledge that this amendment must be in place for 1 April 2007. However, we wish to register serious concerns about the application of these revised figures. These concerns fall into two specific areas:-

- The process by which the figures have been derived.
- The figures to be applied themselves and whether they represent a satisfactory measure of the obligations that should be placed upon the Transporter in their licence.

In the first area, you will be aware from previous representations that we are among a number of industry parties that have been greatly concerned about the manner in which these figures have been derived. In the early stages of the Price Control Review (PCR) the industry expressed great concern at the removal of baselines as these were seen as some form of reference point by which the capability of the system and hence the performance of the Transporter could be assessed. With the restoration of the baselines in the Initial Proposals and Revised Proposals papers, the industry had some confidence that a consistent reference point was being maintained. In the Final Proposals document these

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figures and, it must be assumed the basis upon which they are derived, has changed without any reference or consultation with the wider industry. This confidence in a consistent approach has been undermined by this unexpected change. Although there has been some explanation of this revised approach since publication of the Final Proposals paper, there is still no common understanding of the calculation of these figures and what they represent.

This situation has added to concerns about regulatory uncertainty.

Secondly, as mentioned above there was a degree of confidence in the position adopted by Ofgem. At the time of the Updated proposals paper, it was understood that the baselines represented physical capability of the network. However, in the Final Proposals document it is evident that Ofgem have departed from this premise and appear to have revised this obligation to one which represents little more than that sold to Users. It is also noted that this reduction in baselines has been applied disproportionately in order to accommodate levels of capacity sold. Under the current proposal the baseline is below that of actual flows in recent experience at a number of Entry points and some of the LNG Storage facilities.

These baselines now appear to represent a significantly lower requirement. From a simple calculation, the aggregate of all ASEP baselines is now 12.7% lower than that of the previous control when new obligated incremental capacity has been excluded. In our view, this also reduces any exposure to the risk of buy-backs. It is not certain that this reduction of risk is commensurate with the rate of return that has been adopted in this PCR. An observation is that the allowed rate of return in the Final Proposals increased from that in the Initial and Updated papers where the exposure to risk of buy-backs appears to have been reduced at the same time.

In the context of this Section 23(3) consultation, we cannot be confident that the proposed baselines for System Entry Capacity satisfactorily represent the level of system capability to which the Transporter should be obligated in their licence.

Please contact me if you require any further information.

Yours sincerely,

Mike Young  
Commercial Manager