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Dear Paul,

RE: User Commitment for National Transmission System Quarterly Entry Capacity – Initial Impact Assessment on modification proposals

Thank you for the opportunity to comment on the above Methodology Statement. This non-confidential response is sent on behalf of the Centrica Group of companies, excluding Centrica Storage Limited.

Background

Centrica played a full part in UNC Review Group 0221. Throughout that process, there was a widely held recognition that participants were seeking a UNC based solution to an issue given rise to as a result of the construction of the Transporter licence. At the time a number of comments were made to the effect that any resulting modification proposals were likely to be sub-optimal, possibly also giving rise to undesirable consequences, as a result of tackling the symptoms of the problem rather than the root cause. Following that review, National Grid raised Modification Proposal 0246, and in response we subsequently raised Alternative Proposal 0246B.

Our thinking remains that the costs likely to result from the implementation of either 0246 or 0246A are uneconomic against the scale of the risk that we perceive from this issue, given the requirement of those proposals to securitise all existing holdings. We therefore brought forward Proposal 0246B not in the belief that it presented an ideal solution to the problems faced by shippers, but rather as a less detrimental alternative to the other two proposals.

Against this background, we strongly welcome Ofgem's recognition that solutions might more effectively be found by amending the Transporter licence, in particular the right of the National Grid to automatically collect auction revenues irrespective of post-auction events. We believe that a revision to the transporter licence is the correct approach to tackle this issue, not only dealing directly with the source of the problem, but also significantly limiting the scope for undesirable consequences which may accompany a UNC proposal.

For clarity, our position remains that action to prevent a recurrence of the events at the Fleetwood entry point needs to be taken ahead of the next price control (whether that occurs in 2012 or 2013). We do not believe it is appropriate to continue to expose shippers and consumers to this known risk for up to three further years. As a gas shipper, we are clearly not privy to conversations between Ofgem and National Grid in respect of mid-price control licence changes, and therefore have no means by which to evaluate the likelihood of a successful mid-term licence change. We would therefore look to Ofgem for an assessment on the success of this (our preferred) course of action. We would not want to be in a position whereby all of the possible UNC proposals are rejected and no effective action is taken to tackle the issue through the licence ahead of 2012/13.

We therefore would only continue to support 0246B in the absence of effective action to amend the licence in order to remedy the identified issues. We do not support either of the other 2 related proposals.

Responses to Specific questions

Chapter 2

Q 1. Do you have any additional views on the merits/disadvantages of the options for securitization of capacity to add to those of the review group?

We were able fully to express our views through participation in the Review Group.

Q 2. Do you have views on the ability for NGG to cover the potential of shipper default through commercial insurance instruments?

In relation to this question, we would highlight that use of the term “default” in respect of the UNC only occurs (in this context) when a shipper does not pay a transportation invoice. Failure by a shipper to place transportation credit when required does not result in a default under Code. Respondents should therefore be clear as to whether they intend for an insurance product to pay out in the event of non-payment of credit (i.e. not strictly a default under Code) or only once a shipper has not paid a transportation invoice.

We are not in a position to comment on either the availability or the cost advantages/disadvantages of commercial insurance to cover such an event, but believe that NGG could establish a view on this option relatively easily. The economic availability of such an insurance product could then give rise to a process whereby NGG should be able to demonstrate that it had made a risk assessment of each relevant capacity bid, and decided whether the purchase of insurance was appropriate.

Chapter 3

Q 1. Do you agree with the analysis of the risks involved? Are there any quantifiable risks that have been omitted?

As far as we are able to assess, the Impact Assessment covers all relevant risks.

Q 2. Is the level of securitization being proposed appropriate? If not, why?

This was debated at length by the Review Group. Participants were provided with information on a range of options right up to 100% securitisation. Mindful of the impacts on businesses (especially against the background of the credit crunch) there was broad agreement that 100% would be inappropriate and indeed probably unworkable. Following further discussion, the figure of 10% was suggested. We agree that such a figure would seem appropriate.

Whilst the figure of 10% is essentially arbitrary, we believe it provides an essential incentive towards appropriate behaviour i.e. a deterrent to “non-committed” bidding.

Q 3. Do you agree with the benefits as presented here? Are there any other ways in which the quantitative benefits could be presented?

In cases such as these, past performance (i.e. the number of “defaults” to date) does not necessarily provide a good indication of what may happen in future, and to this extent there has to be a degree of speculation. We believe that Ofgem has done a reasonable job of assessing the potential benefits, and we are not in a position to suggest more suitable figures than those used.

Q 4. How do the risk ranges presented for each of the proposals rank against your perceived risk of default for future capacity bookings?

Since a “loophole” has been exposed in the User Commitment model, and since there is obvious scope for this to be exploited for future gain e.g. capacity trading opportunities, we instinctively believe that if left unchecked the risk of future default will be higher than has been seen historically. This position will be compounded by (in our view) an increase in the rate of applications for incremental entry capacity – primarily to facilitate new gas storage sites. However, as above, it is extremely difficult to assess the likelihood of further actual shipper default.

We would tend to agree that the figures provided appear to be of the right order of magnitude, and accord with the assumptions used in the RIA. In addition, based solely upon the deterrent effects of the proposals, we would tend to believe that at least the bottom end of the 0246B risk reduction could be achieved.

Q 5. Do you have any preference amongst the proposals on the basis of the quantitative analysis?

Our strong preference is for remedial action to be taken through the transporter licence regime. Only in the absence of such action, however, would the figures provided in the RIA confirm our support for 0246B.

Chapter 4

Q 1. Do you think that the implementation of any of these proposals would have an adverse effect on competition? Please give reasons for your answer.

We recognise both sides of the arguments put forward in the RIA – that is, that on the one hand these proposals may act as a barrier to new and innovative players, whilst on the other hand it is the more marginal project carried out by smaller players which are more likely to fail leading to a shipper (and therefore consumer) charge. We are inclined to think that this proposal will not halt or even reduce the number of such new projects by smaller players, but if anything will change the point at which they are sold out to larger players – that being prior to the acquisition of NTS entry capacity.

Q 2. Do you think any of these proposals are unduly discriminatory?

We agree that this is a legitimate concern, and one that needs to be addressed on a number of different fronts depending upon the specific proposal being considered. However, to the extent that there are any lingering concerns about undue discrimination, we believe that these can be avoided by taking appropriate corrective action through the gas transporter licence rather than by the use of any of these UNC proposals.

0245 and 0246A.

Both of these proposals require the securitisation of capacity that has already been committed to. This will introduce additional costs, these being costs which had they been known about at the time could

well have caused the purchaser to make a different decision. Such use of retrospective Code amendments has generally been avoided wherever possible with good reason, and we do not believe that retrospection is either necessary or helpful in this case.

Indeed, a number of discussions have suggested that a key reason for the inclusion of a requirement to securitise existing holdings is not in order to reduce risk to shippers through smeared costs, but rather to overcome issues of perceived discrimination. We do not believe that it is appropriate to require the inclusion of requirements which are costly and of questionable effectiveness, simply to demonstrate equal treatment.

There are a number of instances in other walks of life where rules change for the greater good, even though they give rise to clear discrimination. One example is the national retirement age. Whereas historically retirement (linked to the payment of a state pension) has occurred at (say) 65, future generations will have to work to 67 or 68 before the state will pay them a pension. This is clearly different treatment, discriminating against younger generations, but is deemed to be necessary in response to changes in the prevailing socio-demographic and financial environment.

Q 3. *Do you think the proposals are sufficiently simple and transparent?*

Yes.

Q 4. *What is your preference on the basis of the qualitative issues?*

Our preferred course of action remains an amendment(s) to the gas transporter licence. Failing that, we continue to believe that 0246B best meets the industry's requirements.

Chapter 5

Q 1. *Do you think that shipper termination is a tool that should be more widely used to deal with credit default issues?*

This is clearly an option, but its greater use would have to be accompanied by additional checks and balances. Given its extreme nature, overall this option makes us nervous and, we believe, it can be avoided by utilisation of other neater solutions.

Q 2. *Do you agree that the Income Adjusting Event clause in the gas transporter licence should be reviewed? If so, what manner of changes would you recommend?*

Initially we held out hopes that this clause could be used to deal with events such as those at the Fleetwood entry point. We were therefore surprised and disappointed by the restrictive nature of this clause, linked as it is solely to costs.

The issues that we perceive are primarily twofold. First is the linkage to costs; therefore the exclusion of revenue related events. Second, we believe that the requirement to identify a "trigger" event or date could give rise to significant debate, and potentially cause events to be ultimately ruled out of scope. For example, in a hypothetical case, arguments could be run to suggest that the trigger event was any of (a) the initial bidding for capacity, (b) the allocation of capacity, (c) a refusal of planning permission, (d) the realisation that a facility would not be ready to flow gas on the capacity delivery date, (e) any non-payment of transportation credit, (f) any non-sale of any capacity deferred by the original purchaser and put up for re-sale by NGG, (g) a failure to flow gas on the capacity delivery date, or (h) non-payment of a resulting transportation invoice. At least some of these discussions could be avoided by more appropriate licence drafting.

Q 3. *Do you agree that the revenue driver mechanism for gas entry capacity could be improved? If so, how?*

Although providing certainty to NGG, the automatic triggering of a revenue driver now appears to be a somewhat flawed concept given the experiences at the Fleetwood entry point. Rather, it may be preferable for the revenue driver to be subject to an Ofgem veto prior to it coming into effect, thereby allowing the opportunity for a review of the circumstances involved in the particular case. We also wonder whether there could be a greater role for elements such as demonstration dates, as used in the NTS exit regime.

Q 4. *Do you have a view as to whether the Authority's role in the approval of NGG NTS proposals to release incremental capacity is no longer required?*

If the incremental capacity release regime remains unchanged, we struggle to see what value the Authority veto has. However, changes to the regime could mean there is a role for an Authority veto, possibly even a broader role. For example (and just thinking aloud) the ability for the Authority to veto incremental capacity once work had started, in consultation with the original bidder, could have been another way of solving the Fleetwood issue e.g. cancel the original incremental signal, remunerate NGG for expenditure to date, and then require the process to commence anew if the original bidder, or another bidder at the same ASEP, wanted to progress with the development.

Q 5. *Are there any other options, outside of the UNC, that could be considered for making the entry capacity credit arrangements more robust?*

We perceive that NGG has approached this problem from a viewpoint of complete neutrality to risk, whereas in reality NGG is remunerated through the price control to accept a degree of risk. (In the Fleetwood example, we cannot accept that NGG is taking a risk by not developing the required entry capacity).

It could be helpful to clarify whether NGG's risk exposure over time accords with the rate of return allowed during price controls. It may then be helpful to assess whether any shortfall is allocated risk should be addressed through greater exposure on the entry front.

Please don't hesitate to contact me if you have any queries in relation to this response.

Yours sincerely,

Chris Wright
Commercial Manager