Centrica Energy

Millstream East
Maidenhead Road
Windsor
Berkshire
SL4 5GD

Tel. (01753) 431059
Fax (01753) 431150

Mr. John Bradley
UNC Panel Secretary
Joint Office of Gas Transporters
1st Floor South
31 Homer Road
Solihull
West Midlands
B91 3LT

Our Ref.
Your Ref.

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Dear John,

RE: Modification Proposals 0230 and 0230A: "Amendment to the QSEC and AMSEC Auction Timetable"

Thank you for the opportunity to comment on these proposals. British Gas opposes the implementation of either. The main reasons for our opposition are:

- The movement of AMSEC from February to June (with capacity release dates moved from April to October respectively) removes the primary opportunity at which Shippers shape their summer capacity holding with the benefit of knowledge of offshore and onshore maintenance plans.

- The movement of QSEC from September to March exacerbates a current situation whereby the same capacity period is usually offered for sale at two different prices both of which are known about at the same time, in advance. Post 2010, both proposals extends this overlap from 6 to 12 months.

- In the case of 0230, the unnecessary and excessive delay between QSEC auctions. This delay was not formally known about at the time of the latest QSEC auction in September 2008.

- Both proposals ultimately seek to condense the longer term Entry, and proposed forthcoming Exit, booking processes from the current 7 month window, into just 4 months.

- We agree that by moving the incremental capacity delivery point to October, with the last 6 months being summer months, both proposals seek to provide greater certainty to the delivery of incremental capacity. However, this will also materially reduce National Grid's risk level in respect of failure to deliver that capacity. That risk level was set by TPRC4 against a fixed rate of return, and cannot be revised without re-opening that price control.

Whilst on the face of it these proposals seem relatively straightforward, we are concerned that there would be a number of serious detrimental implications for Shippers were either to be implemented. Conversely, the advantages would seem mainly to fall to National Grid, particularly in terms of lower risks around the delivery of incremental capacity.

Movement of AMSEC

In 2003, British Gas Trading raised Modification Proposal 616 – *'Revision to the Standard Year for purposes of acquiring and holding Annual Monthly System Entry Capacity'*. That proposal was widely supported by Shippers and Transco, and implemented by Ofgem. The proposal had two main drivers. First, it sought to link the release of capacity to the formula year. Second, it established the timing of a February AMSEC auction, with an April capacity release date.

The proposal specifically highlighted the link between the February auction date, and Shippers' understanding of Transco (as was), and offshore producer, outage and maintenance plans for the coming summer. Shippers' understanding of outages and maintenance plans develops during the winter months, culminating in firm maintenance/outage plans for the coming summer being fixed at the beginning of February, in time the AMSEC auction process. Shippers, therefore, traditionally use the February AMSEC process to shape their summer capacity holding around this latest available information.

Ofgem acknowledges the importance of a February AMSEC in its decision on Modification 616. In its decision letter, Ofgem states: "*Further, conducting AMSEC auctions in February will allow shippers access to more reliable planning and maintenance information for the summer months which should enable shippers to value capacity more efficiently. This should better facilitate competition between shippers and should assist Transco in determining whether to adjust its own maintenance programme to minimise capacity buy-back costs, thereby better facilitating the efficient and economic operation of Transco's pipeline system.*"

Modification Proposals 0230 and 0230A both seek to move the AMSEC auction date to June, and the capacity release date to October. Such a move would completely undermine this specific, and crucially important benefit, of the February AMSEC process.

Clearly Shippers will know offshore maintenance plans in time for the June auction, but not only are they likely to already be part way through the maintenance period by then, but a capacity release date of October means that they will have completely missed the opportunity to buy their capacity requirements around those maintenance plans in a longer term auction. In this instance, a June auction/October release comes too late in the calendar year to be of any real benefit.

A June/October combination is also far too early in the maintenance cycle for most if not all Shippers to buy their capacity for the following year, since maintenance plans are likely to still be extremely fluid at that stage. In this respect the timing of the AMSEC under both proposals is far too early to be of benefit for the coming year.

Further, an October release date would coincide with the start of the requirements for winter capacity. We would suggest that most, if not all, Shippers with UKCS produced supplies are likely to plan for their production to increase significantly, or be fully on, at that stage. In fact, we believe that the certainty of winter demand means that most Shippers will have secured such capacity in the QSEC auction process, possibly many years in advance. We believe that a review of the available information on capacity sales tends to support this view.

In terms of charges, the timing of the AMSEC auction is critical. It could either lead to over-booking of summer capacity in AMSEC auctions or, more likely, to more summer capacity being booked in RMTTSEC auctions. There may then be a second order effect if the latter occurs because National Grid may find it more difficult to predict auction revenues and hence there may be more scope for setting TO Entry commodity charges incorrectly.

We therefore strongly oppose this aspect of both Proposals. Whilst we recognise that the capacity regime overall has evolved since modification 616 was implemented, nothing significant has changed in terms of the requirement for maintenance outages, the timing of these outages (i.e. during the summer), or the timings of the maintenance planning process. Therefore, we believe the implementation of either of these two proposals would be as harmful to the relevant objective set out in Standard Special Condition A11.1 (d) (i) – to secure effective competition between relevant Shippers – as the implementation of 616 was beneficial.

Similarly, we believe implementation of either would be harmful to the economic and efficient operation of the network, which Ofgem believed was enhanced by proposal 616 by virtue of allowing Transco to flex its maintenance plans around capacity signals received through the AMSEC process, as set out in the Ofgem decision above.

Movement of QSEC

In 2003, British Gas Trading put forward modification proposal 0617, which sought to establish an annual QSEC process in September each year, with a capacity release date for incremental and baseline capacity purchases of April. That proposal was widely supported by Shippers and Transco and was directed for implementation by Ofgem.

Proposal 0230 intends that there should not be a QSEC process at all in 2009, and that from 2010 QSEC henceforth should be held in March. Proposal 0230A plans for a September 2009 QSEC, with all subsequent QSECs being held in March.

We do not *per se* oppose the principle of moving the QSEC auction process, and consider that there is less of a requirement to maintain its current position in the calendar year than is the case with AMSEC. However, under the current regime, the movement of QSEC to March would create a number of significant concerns to us.

Auction timings

Proposal 0230 was only put forward after the 2008 QSEC process had concluded, giving Shippers neither the opportunity to prepare a bidding strategy around the absence of a 2009 QSEC, or indeed to execute any bids on this basis.

We recognise the arguments put forward to support a movement of QSEC in order to provide the last 6 months as summer months during which physical building of new capacity can take place. If all else remained equal, this would be an acceptable argument. However, it must be recognised that following TPCR4, National Grid now benefits from an additional 6 months in which to deliver new capacity compared to the TPCR3 regime. National Grid gave its agreement to this price control, including this additional 6 month build period, in the full knowledge that the additional 6 months were winter months. National Grid's cost of capital, and therefore costs to Shippers and consumers, reflects the balance of benefits and risks inherent in its acceptance of TPCR4, including the timing of this capacity release obligation.

By adjusting capacity delivery timings as set out in 0230 and 0230A, National Grid's capacity buy-back risk from failure to deliver incremental capacity will, although capped by TPCR4, be reduced further still. While it could be argued that Shippers will benefit from greater certainty around the delivery of incremental capacity, this is capacity that National Grid is currently obliged and incentivised to deliver on time. Indeed, we are reminded of the extensive debate that took place around the development of the capacity Trade and Transfer regime, where a highly significant factor in the setting of exchange rates was National Grid's insistence that there must be no material change in its buy-back risk. We believe that this proposal would give rise to such a material change.

In its proposal, National Grid suggests that moving the capacity delivery date from March to October will reduce the risk of gas being stranded offshore. We do not believe that this is a credible benefit of this proposal. Under the current regime, incremental capacity is required to be delivered in April. Therefore, any delay to the delivery of incremental capacity will fall in the summer period with the accompanying lower gas demand. This represents a low risk to security of supply. Conversely, a delay to an October delivery date, as proposed, will fall into the winter period, thus increasing the likelihood of gas being stranded offshore. We believe that such a move therefore, would compromise both security of supply and the efficient operation of the pipeline system (A11.1 (d)).

Delay to QSEC under proposal 0230

In terms of the detriment caused by the 18 month delay between QSEC auctions under proposal 0230, National Grid has stated in industry discussions that it would be willing to work with any party who was planning to bid for incremental capacity in order to arrive at a solution whereby the delivery of that capacity was not unduly delayed as a result of the later auction. Examples of ways in which this could be achieved have been suggested as signing a pre-works agreement.

Whilst we appreciate National Grid's efforts to assist the industry on this point, it must be recognised that this work-around has been put forward in order to offset the detriment caused by National Grid's own proposal, and provides no net benefit to Shippers. Indeed, we believe that this approach could further undermine the User Commitment model.

Since the introduction of the User Commitment model, National Grid has repeatedly stated that it will only deliver incremental capacity in response to signals received from Users through the QSEC process. This is well understood by Users. The approach being adopted as a compromise for this proposal would tend to suggest that alternative approaches are available to delivering incremental capacity, albeit at National Grid's discretion. Whilst we believe that the current User Commitment regime is imperfect, and believe that greater use could be made of alternative approaches such as pre-works agreements, ARCAs etc, we believe that the application of these arrangements need to be considered holistically rather than on a piecemeal or discretionary basis.

<u>Capacity Charges</u>

Currently, prices for entry capacity are released by National Grid in July each year (year Y), with those prices covering a period of October Y to September Y+2. We attach as appendix 1 a timeline showing the current position with regard to prices and auctions. As can be seen, under the current regime, there is a 6 month overlap between QSEC and AMSEC capacity, i.e. the same 6 month strip of capacity can be bought at different prices at a QSEC and subsequent AMSEC auction.

Our understanding is that, upon implementation, proposal 0230, and proposal 0230A from 2010 onwards, will exacerbate this problem by doubling this overlap period, giving a 12 month overlap in total. Again, this can be seen at appendix 1. Given that this additional 12 months will include a winter period however, the volume of capacity in question is likely to be significantly more than double the current arrangement which only covers summer months.

For example, the QSEC held in March 2010 will use the 2012/13 prices throughout its release period, including capacity for Oct 2011 to Sep 2012 even though a set of prices has been published in Jan 2010 for those 12 months. In parallel, the AMSEC to be held in June 2010 will use the prices as published in January 2010 for all months, including for Oct 2011 to Sep 2012. Hence there will be a 12 month overlap, with two auctions held three months apart releasing capacity at potentially different prices.

We believe that this could give rise a significant change in Shipper capacity buying behaviour, as Shippers seek to bring forward, or delay, capacity purchases depending on whether the published prices were set to increase or decrease. We do not believe that this is a desirable outcome, as it will lead to less efficient valuation of capacity by Shippers. This, in turn, will damage competition between relevant Shippers, counter to relevant objective A11.1 (d) (i).

We would also question the extent to which these proposals accord with the obligations placed on National Grid by its Licence to sell capacity on a cost reflective basis. Standard Special Condition A5 of the transporter licence requires National Grid to develop a charging methodology so that "*compliance with the charging methodology results in charges which reflect the costs incurred by the Licensee in its Transportation business.*" It is difficult to see how selling the same capacity in the same pricing period, at two potentially very different prices, can reflect the costs incurred. This is particularly the case where the overlapping period is 12 months.

Whilst this anomaly currently exists and is apparently tolerated by Ofgem and Shippers, we consider that exacerbating the matter as a result of implementing either 0230 or 0230A would be harmful to the relevant objective set out at Standard Special Condition A11.1 (c): the efficient discharge of the licensee's obligations under this licence.

We also believe that if either of these proposals were implemented, further industry change would be required, either through the modification process or through a change to National Grid's licence or charging methodology, in order to remove the extended charging period overlap created by these proposals. Indeed, in its proposal National Grid highlights that it is likely to seek a change to its licence to accommodate this proposal. Given the extremely limited or even non-existent benefits to Shippers brought about by 0230 and 0230A we consider that this would be harmful to the promotion of efficiency in the implementation and administration of the network code as set out in A11.1 (f).

<u>Spacing of auction processes</u>

Proposals 0230 and 0230A both seek to condense the annual auction timetable. The current auction timetable of February (AMSEC), July (Exit) and September (QSEC), spaces three processes over a 7 month period with a probable two month gap between the two closest processes. The revised timetable of March (QSEC), June (AMSEC) and July (proposed Exit) squeezes these three processes into just 4 months, with a probable 1 month gap between the two closest processes. We do not see how this can possibly be beneficial to the industry overall.

Should you have any queries with regard to this response please do not hesitate to contact me.

Yours sincerely,

Chris Wright
Commercial Manager