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Dear Malcolm,

Re: Centrica Storage Limited response to National Grid Open Letter on the development of an Inter-day Linepack Product (11 Jan 2011)

Centrica Storage Ltd (CSL) welcomes the opportunity to participate in the debate on the development of a Linepack Product.

We have appreciated National Grid (NG) effort to engage with the industry in this complex process and we would like to continue to offer our help in making it more effective and efficient.

We understand that NG has the licence obligation to develop a marketable product of the linepack flexibility, the so called Inter-day Linepack Product (ILP). However, we are concerned that the introduction of such a product may not facilitate the NG relevant objectives to facilitate the efficient and economic operation of the pipe-line system and to secure effective competition between shippers¹. Hence, it may not provide overall benefits to the shipper community.

We understand that linepack is the amount of gas inside the NTS that can be managed flexibly by controlling the operation pressure levels between a minimum and a maximum level. As System Operator (SO), NG uses this flexibility tool to manage shippers' imbalance positions throughout the day. However, as the management of such flexibility produces a real cost, i.e. compressor usage, we understand the need to apportion this cost to the relevant users, i.e. shippers. So far, the issue has been addressed by a mix of incentives to both shippers and the SO².

While CSL supports the ongoing review of Cash-Out arrangements, we do not see the introduction of a ILP will facilitate the above relevant objectives. In particular, we do not agree with NG conclusions³ regarding the beneficial effect of transforming the linepack flexibility into a marketable product. On the contrary, we believe it may have the following negative impacts:

¹ as set out in Standard Special Condition A11 of NG NTS license

² Shippers have the incentive to balance their final daily position before the market closure in order not to incur in penalizing charges, as set out in the Cash-Out Arrangements. National Grid has the incentive to keep constant the inter-days line-pack level, as set out in the Residual Balancing incentive to System Operators.

³ NG believes that "*implementation of the proposed new service will provide a benefit to Shipper Users as it seeks to facilitate additional utilisation of NTS system Linepack as an additional balancing tool for Users; and it seeks to reduce the potential for cross-subsidy between end of day Linepack utilisation and system balancing costs*" (Open Letter, pg 4)

1. introduce a perverse incentive to delay shippers' decision to cover imbalance positions;
2. decrease NG ability to forecast linepack demand volatility;
3. introduce additional complexity over the valuation of short-term flexibility.

With regard to our first point, assuming the ILP price on day D is forecast to be lower than any other flexibility product available on the market, a shipper holding an imbalance position will have the incentive to take no action against its imbalance till the last release of ILP has occurred (at 23:00, if it has not been entirely allocated yet). However, at that time it may be too late to trigger the use of another flexibility product (like short-term storage) to cover the position. When the shipper fails to cover such position, final NTS balance will be negatively affected.

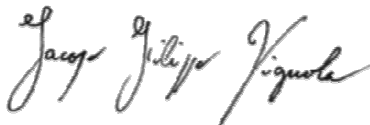
With regard to our second point, selling the linepack flexibility through a zero-reserve price auction would make the daily demand for linepack be driven by commercial forces (in the form of inter-day gas price differential) instead of the current operational ones (accidental imbalance positions). Under the proposed methodology, NG will determine the ILP quantity to release taking into account a number of factors, including the commercial impact of the ILP release. We have concern that adding a commercially-driven variable in the day-ahead computation of available linepack may negatively impact on SO ability to forecast and manage NTS flexibility⁴.

With regard to our third point, because the ILP will be released in pay-as-bid auctions, small shippers with limited analytic ability (like tracking market trends and modelling forward prices) will find difficult to set up an ex-ante valuation of the demanded flexibility. The introduction of additional complexity over the valuation of short-term flexibility does not facilitate the effective competition among shippers.

In conclusion, we believe that the introduction of ILP may not facilitate the efficient and economic operation of the pipe-line system and to secure effective competition between shippers. We therefore urge National Grid to provide the reasons why the above negative effects are unlikely to occur or are negated by the benefits of introducing a ILP.

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

Your sincerely,



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⁴ In the “*Inter-Day Linepack Product Methodology Statement*” (January 2011), National Grid addressed the commercial impact of LP release as a “*secondary factor*” for the purpose of computing the available (and, thus, releasable) Linepack quantity; however, we have concern that the potential impact of adding commercial uncertainty in the computation methodology might be underestimated.