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Dear Colin,

RE – NTS GCD11: Updating the Cost Inputs to the NTS Optional Commodity Charge Function

Centrica welcomes the opportunity to respond to the questions set out in this discussion document. This response is on behalf of the Centrica Group of companies excluding Centrica Storage.

Our main conclusions are as follows:

- These proposals for changing the Optional Commodity Charge (OCC) formula should be governed by the UNC Modification Process as they represent material changes to key assumptions underpinning the charging methodology.
- We therefore have significant concerns about the governance surrounding the current proposals and are especially concerned about the lack of formal engagement with Ofgem.
- The current formula for deriving the OCC should remain in place for existing off-takes utilising short-haul; shippers and consumers should not be penalised for having made historical decisions to use the OCC rather than invest in alternative transportation arrangements at historical cost levels.
- Therefore, updated OCC formulae should only apply to NTS off-takes utilising the OCC for the first time.
- The EU Tariff Code and Ofgem's Gas Transmission Charging Review may require major changes to wider GB transportation charging arrangements and it is therefore unhelpful and premature, before these arrangements are known and fully considered, to change any aspect of the OCC methodology, including the OCC formula.
- It would be very helpful for National Grid to release the model used for establishing the OCC formula. This would provide some transparency on how costs are translated into charges and help industry better understand the mechanics of how the charges are derived. It would also facilitate an understanding of how the modelling assumptions are applied.
- Frequent changes to transportation charges are unhelpful for shippers and consumers. Updates to the OCC should be no more frequent than once a year and this should be from a 1 October date to coincide with the commencement of the Gas Year and the typical start date for

commercial gas sales contracts. Specifically, any change arising from this current review should not be made prior to 1 October 2016 in order to allow shippers sufficient time and scope to amend agreements with their counterparties.

- The Discussion Document does not consider the impact of change on consumers or on the efficiency of the gas market. This is a major shortcoming and needs to be considered via an Impact Assessment.

- In particular, many gas-fired generation sites make use of the OCC and the stability this provides for gas transportation commodity charges is an important factor in helping to keep such sites economically viable. Transportation charge variability (and lack of predictability) is already very high and we want to have less, not more, of this as it is unhelpful.

- The importance of gas-fired generation in providing security of supply for the electricity sector is significant and this needs to be analysed as part of the Impact Assessment.

Question 1: Do respondents prefer Option One or Option Two as the most reasonable approach, and most consistent with facilitating the relevant objectives, to update the underlying costs of the formula in an effort to bring the NTS Optional Commodity charge formula more up to date?

Both approaches take a very narrow perspective of how the Optional Commodity Charge (OCC) should be calculated and applied. If National Grid were to completely overhaul and replace the NTS then Option 1 would seem appropriate but this is wholly unrealistic. To the extent possible, National Grid should reflect the historical/ actual costs of constructing the NTS in its charges and Option 2 would be more in keeping with this.

We question the use of RPI for the indexing of pipeline costs – this is not reasonable and the case for justifying it has not been made.

National Grid should apply to the OCC the same consideration they would give to their pipeline investment decisions, i.e. once the investment has been made then a reasonable return should be made on this investment over a suitable time period. Such an approach should be applied to a shipper's decision to opt for the OCC instead of investing in an independent pipeline – once the decision has been made then it should prevail over a reasonable timeframe. Essentially, shippers may have lost the opportunity to economically invest in alternative gas transportation arrangements because they instead chose to pay the OCC – this was an historical decision. Therefore, the clock should not now be reset – we would not expect National Grid to replace the NTS with new infrastructure now at prevailing costs and in the same way we should not expect shippers who have utilised the OCC to be forced to decide whether they now want to build an alternative pipeline at prevailing costs. In other words, shippers who have opted to utilise the OCC for certain NTS off-takes should be regarded as having made long-term investment decisions and this form of investment decision should continue to be respected.

If implemented, an updated OCC should only be applied to NTS off-takes opting for the OCC for the first time from the date of implementation, and for these the Option 2 cost basis would be more appropriate than Option 1 for the reasons already mentioned. But an updated OCC should not be applied to NTS off-takes utilising the OCC before the date of implementation.

Question 2: Do you agree with the proposal to delay reviewing the methodology/ access and flexibility of the NTS Optional Commodity charge until EU TAR/ GTCR is more certain?

There should be no change to the OCC methodology or formula until there is a full understanding of how the EU Tariff Code and Gas Transmission Charging Review will impact on wider transportation charging arrangements. Whilst we recognise that National Grid is obliged to review its charges and charging methodologies from time to time, the current focus on the OCC is premature. Any concerns that National Grid might have over appropriate means of revenue recovery might disappear or be considerably lessened should a new charging framework be introduced in a few years' time.

For example, the TO entry commodity charge might no longer be required to enable National Grid to recover shortfalls in TO entry capacity revenue if “floating” capacity charges are introduced along with lower discounts for short-duration capacity products.

We should point out here that any concern National Grid might have about not recovering TO entry commodity revenue because of the prevalent use of the OCC is misplaced in our view – the primary concern should be the failure to obtain an acceptable level of revenue recovery from the purchase of entry capacity. However, previous attempts by National Grid to address the shortcomings of the current capacity charging regime for NTS capacity were not, at the time, favoured by Ofgem.

There could, of course, be a complete change to the way in which short-haul forms of product are structured. Our understanding is that the EU Tariff Code might require such products to provide for discounts to capacity charges. If this were to be the case then a complete re-think of current GB arrangements would be required.

It is unhelpful for shippers and consumers to have frequent and major changes to their transportation costs. Therefore, the current options being discussed for the OCC should not be taken forward at this time.

Question 3: Do respondents agree with our proposed approach on timescales for notifying a change to NTS Optional Commodity charges, following the same notice periods as for other NTS charges? If not what do you believe these should be?

We do not agree with the proposed approach.

We are very concerned about the lack of formal governance for the OCC and believe that a more rigorous approach should be taken before any change is made. The options being considered in the Discussion Document constitute major changes to cost assumptions and these assumptions should be treated as essential components of the charging methodology. The fact that the Discussion Document considers two Options on cost inputs supports our view that these cost assumptions form an integral part of the charging methodology and that the methodology is not prescriptive in the costs to be used for deriving the OCC.

Furthermore, the method of deriving OCC formulae from different cost bases is lacking in transparency and it is impossible for us to therefore determine whether simply changing levels of input costs remains a credible and sufficient basis for change. National Grid should make their OCC charging model publicly available, as they have done with their other charging models, to help better inform the debate and to allow interested parties to better understand the mechanics of how the charges are derived.

A more appropriate approach for changing the OCC should therefore be via the UNC Modification Process. This will allow for a more managed and rigorous consideration of proposed changes and will ultimately require Ofgem to decide on whether or not implementation of any change proposal is appropriate. The absence of any role for Ofgem in the current approach is a major concern.

Question 4: Do respondents believe 1 April 2016 is an appropriate implementation date? If not what do you believe the implementation date should be and why?

For the reasons provided in answer to Question 2, we do not think that changes should be considered at this time with a view to implementing them next year.

In the medium to long term, if changes were to be made to the OCC it would be natural to anchor them to 1 October, consistent with the commencement of the Gas Year and a typical check point for supply contract commencements or renewals.. Changes to TO and SO commodity charges can and do occur from 1 April as well as 1 October but this is largely in response to differences between actual and forecast revenue recovery over the winter period. Therefore, implementation of any formula change should be aligned with a 1 October start date. On this basis, making changes effective from 1 April 2016 might not help shippers to readily amend agreements with counterparties so an earliest implementation date of 1 October 2016 would be more reasonable.

Question 5: Are there any elements that you feel we should take into consideration, or that you believe we have missed and should take into account, in the two options being considered for reviewing the NTS Optional Commodity Charge?

It is vitally important that the impacts of any change to the OCC on consumers and the efficiency of the gas market are carefully analysed and considered. If, as we argue, the proposed changes were to be managed via the UNC Modification Process then we would reasonably expect Ofgem to conduct an Impact Assessment as part of their decision-making process.

Such an assessment should consider:

- The impact on large NTS consumers generally
- More specifically, whether gas-fired generating plant might become uneconomic with consequences for the security of supply for electricity
- The effects that changes to the OCC might have on the gas market, noting especially how gas flows via the three interconnectors might be impacted.

If Ofgem is to continue to be excluded from the current process for change then we would expect National Grid to conduct such an Impact Assessment.

More generally, we continue to have significant concerns with the very high variability and unpredictability of transportation charges from year to year. This is an issue that needs to be addressed by National Grid as a priority and with a better appreciation of how changes to transportation charges impact on shippers and consumers. Introducing frequent changes to the OCC will only make matters worse.

We would welcome the opportunity to further discuss and explore the issues raised in this response with you .

Yours sincerely,

Graham Jack
Regulatory Manager