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Ofgem
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4th June 2010

Dear Bogdan

Ref 56/10 Proposed disposal of part of NTS for Carbon Capture and Storage – Second consultation and initial impact assessment

Thank you for the opportunity to comment on the above. This response is sent on behalf of Centrica group companies excluding Centrica Storage.

Where possible, in order to allow structured analysis of responses, we have aligned our response to those questions posed in the consultation paper. Where the structure of the questions does not facilitate this we have added additional comment.

We are supportive of this initiative which addresses the very real and current problem of carbon emissions. We are leaders among energy companies promoting and developing energy efficiency and alternative sources of energy. It is undoubtedly in the interest of the wider community, to trial the technology proposed in this project which, if successful, will provide further mitigation of the effect of combustion of carbon based fuels.

CHAPTER 4: Future flows at St. Fergus and pipeline capability

Question 1: What is your view of the conclusions drawn about future flows and capability based on the consultants' reports?

We commend the inclusion of the consultants' reports and these do provide an independent confirmation that the analysis and assumptions which have been adopted by National Grid Carbon are reasonable. One central assertion we would question is the extent to which LNG deliveries will suppress Norwegian supplied gas. Whilst this is inevitably true whilst world prices are low, this may not always be the case. We would welcome some further analysis and modelling of the potential impact of higher LNG supplies upon St Fergus flows.

Further, the removal of one pipeline will reduce linepack as NG acknowledge. In the assessment of forecast flows undertaken by the consultants, we would like to see confirmation that this would have no impact upon the current within day variation of flows. This is particularly relevant as it appears that most analysis has been based upon peak day.

CHAPTER 5: NGG's revised proposal

Question 1: What is your view of the structure of the revised proposal overall?

We are content that the structure of the revised proposal has, in the main, addressed to points and concerns expressed from the original consultation. The questions posed rightly relate to those areas which are still to be decided upon which are contained in the following sections.

Question 2: What is your view of the treatment of incremental buyback, opex, CFU and other costs identified?

Without question it is correct to apportion all of the additional costs including risk of capacity buybacks, Opex, CFU etc to the NG(Carbon) activity. This project is made possible by some redundancy of the existing gas transmission network. It would not be appropriate for any further costs or risks to be borne by gas consumers.

Question 3: What is your view of the suggested approaches to asset valuation?

We have some concern that the valuation of the asset is biased in favour of arriving at a low value. The various feeders built to bring gas from St Fergus were constructed at different times. At these times the investment would have been made on the basis of the usual criteria (RoR, asset life, depreciation etc.). There has been an assumption that the line proposed for CCS use is toward the end of asset life therefore valuation is low. Therefore, it does appear that a "First In, First Out" (FIFO) approach has been used in this case. The effect is therefore that a relatively high price has been paid by consumers to build the asset which is now very low in value due to current circumstances. It would be more realistic to apply the depreciation of the actual pipe being used. We understand that these pipes may not be interchangeable along the entire length, particularly to make the connection to the source of Carbon, but it would appear to be sensible to use the most recently installed of the pipes as it should be expected that its life for Carbon transportation would be of longer duration than those continuing use for gas. This would suggest that a "Last In, First Out" (LIFO) approach to the residual value is more appropriate. At very least, it could be expected that some pooled average of the asset values would be applied, rather than simply identifying that closest to the end of its asset life. Any other approach would undoubtedly mean that the asset valuation would be higher.

A test of this valuation would be to evaluate that figure would have sold the asset to a third party for a similar development.

Due to those same circumstances it could be said that the "loss" of potential revenue to NGG is zero. Arguably, all revenues from the sale of assets should be applied in total to reduce transportation charges which would see the maximum benefit being accrued to consumers.

Question 4: What is your view of the proposal for sharing the benefits of increased CO₂ throughput?

We have asserted that the gas consumer must be insulated from the costs and risks of this venture. Although it could be argued that the project could be completely isolated from National Grid's other businesses outside National Grid Carbon, we strongly support the view that the project is underpinned by asset which has been funded over time by gas consumers it is entirely appropriate for these consumers to receive a significant share of any upside identified.

Question 5: What is your view of the suggested mechanism for returning value to gas consumers?

Reduction of transportation charges is the most effective way to apply any benefit to consumers. This should follow from the appropriate reduction of the RAB as well as any share of the upside from CCS usage.

Question 6: Are there any other considerations which have not been taken into account?

We believe that there has been insufficient account taken of the effect of Substitution. This has two potential effects. Firstly that substitution of unsold capacity could result in a permanent reduction in baseline capacity. Although this reduction is largely commercial, it would have some physical effect as greater flows at other entry points facilitated by substitution have a physical effect in reducing the ability to enter gas at St Fergus. A further effect is that the higher utilisation of remaining capacity at St Fergus may result in a different (less favourable) exchange rate being applied to capacity under a substitution mechanism. This is particularly relevant as it is common knowledge that a number of Storage and LNG delivery projects in the north of England are under consideration.

We believe that both these elements of the effect of substitution must be included within the final analysis.

Appendix 2: Initial Impact Assessment

Question 1: Do you agree with our initial assessment of the impacts of the proposal for the disposal of assets?

As commented above, we believe that a different approach to asset valuation would produce a result which is more realistic and represents better value to gas consumers. The potential value if sold to a third party would also provide a useful comparison when considering these impacts.

Question 2: Are there any quantitative benefits or costs that have not been included in our assessment?

As mentioned above, the impact of Substitution does not appear to have been considered.

In addition, there is an impact upon linepack. NG acknowledge that the removal of the pipe will reduce linepack but it will have no impact as there is plenty of linepack in the area. This has been our contention all along but in the event of the introduction of a linepack service, any additional costs (including loss of potential revenues) for the line pack service must be tagged and allocated to the CCS service.

Further, we would also like to see some assurance that the maintenance programme can still be operated without any additional disruption to capacity available.

Question 3: Are there any qualitative benefits or costs that have not been included in our assessment?

The removal of a feeder from the NTS linking St Fergus may create an indication of lower capability, although the current baseline will be maintained. This effect is impossible to quantify but may have an impact on the sentiment of actual and potential capacity holders at St Fergus.

Question 4: Are there any other considerations that have not been included in our assessment?

We are not aware of any.

We trust that these comments are helpful and constructive in reaching a conclusion on the development of this project.

I would confirm that nothing contained in this response is considered confidential and we are content for it to be available on your website for view by interested parties.

Please let me know if you require any further information.

Yours sincerely

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