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Debra Hawkins
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Friday, 22nd February, 2008

Dear Debra,

RE: NTS GCD 05: SO Storage Commodity Charging

E.ON UK remains unconvinced by the need for a SO Storage Commodity charge. The only conceivable benefit of implementing this proposal would be a small increase in cost-reflectivity. However, when considered alongside National Grid's other transportation charging methodology "relevant objectives" (as set out in Standard Special Condition A5.5 of National Grid NTS's Gas Transporter Licence), we struggle to see how this proposal would improve on the current charging arrangements. Given that National Grid envisages a maximum annual SO revenue of just £2.5M to be collected from such a charge and that most of this would be to cover internal fixed costs associated with administration of the charge itself, there would appear to be no discernable improvement achieved by implementing an SO Storage Commodity charge.

Furthermore, we do not believe that continuing to charge storage sites in a different way to other system users constitutes undue discrimination. The imposition of a SO storage commodity charge cannot, therefore, be justified on this basis. As highlighted in our previous response to Modification Proposal 120V – "Introduction of an SO Commodity Charge for NTS Storage Exit Flows"; where classes of NTS Users are not materially comparable, different treatment can be appropriate.

Additionally, given that the commodity charge for non-storage flows would accordingly only reduce by approximately one per cent, we do not believe that there is a cross-subsidy here to be concerned about. As such, we do not believe that an SO Commodity charge can be justified on the basis of the avoidance of a cross-subsidy, pursuant to the EU Gas Regulations.

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Benefits of Gas Storage to the NTS

As National Grid highlights, storage has, historically, been considered to be a part of the wider system. By its very nature, it aids in the overall balancing of the system by generally putting gas into the system on peak demand days and withdrawing gas during periods of low demand. In doing this, it actually provides a valuable service by smoothing-out demand. Indeed, the recent Waters Wye report for the Gas Storage Operators Group concluded that certain entry points *"…do provide a benefit to the transmission system because on peak days they deliver to the system close to consumer demand, thereby reducing the need for pipe and compression capacity between alternative sources of gas and the demand."*

On this basis, we disagree with Ofgem's previous statement in its decision letter to reject Mod 120V that in reviewing the charging methodologies, the benefits of storage to National Grid should be excluded. Some entry points (i.e. those with negative Long Run Marginal Costs – many of which are storage facilities) are actually providing a benefit to the system via reverse flows. As such, it would seem unfair to charge these storage facilities a commodity charge when rather than contributing to costs are (when flowing gas to meet peak demand) potentially reducing them. We believe it is important to recognise the benefits of gas storage in aggregate to the NTS and that this is significantly more important than attempting to be cost-reflective by analysing components of a relatively small value storage commodity charge to intricate levels of detail.

We believe that more industry focus should now be placed on recognising the benefits of certain entry points to the system, which would improve cost-reflectivity in the charging methodologies significantly more than the imposition of a proposed SO Storage Commodity charge. E.ON UK has initiated industry discussion on this topic in the NG TCMF meetings and in contrast to the SO Storage Commodity charge proposal, it has received industry support.

Fast-Churn Storage

We believe that the impact of a proposed SO Storage Commodity charge on fast-churn storage has not been adequately considered in this discussion paper. Applying a simple *p/kWh* commodity charge to all storage unfairly penalises the fast cycle sites, which will churn many times in a year. This is because the costs that the storage commodity charge are funding are fixed; i.e. NG NTS' internal costs, largely. On this basis, storage facilities that churn most frequently would be penalised most, despite the fact that many of them are, by virtue of their location on the NTS, providing more benefit to the system (or at least maintaining a neutral impact) the more they churn. Since many new storage sites connecting to the NTS in the near future will be fast churn sites, it is clear that these would be treated disproportionately by a *p/kWh* charge approach, which may ultimately discourage new fast churn sites from connecting to the NTS. This would clearly be an undesirable outcome.

Physical vs. Commercial Flows

Ofgem has previously stated that it believes a proposed SO Storage Commodity charge should only be applied to physical flows, not to commercial flows. As highlighted in this discussion document, however, to base this change on physical flows "will involve considerable IS cost", which could actually outweigh the revenue recovered (and any perceived benefit) from the charge. Furthermore, it will also increase the overall SO costs, which will ultimately find its way through to end-user prices.

Conclusion

In summary, we do not believe that any improvement to the current charging methodology arrangements would be achieved if a Storage Commodity charge were to be introduced. We believe the evidence put forward by National Grid in both the TCMF meetings and this discussion paper demonstrates the lack of an economic rationale for the imposition of this charge. Given the potential for significant unintended consequences (for instance, the impact on fast-churn storage) we do not consider that levying a SO commodity charge on storage would produce any measurable benefits.

I hope you find these comments useful, but if you wish to discuss them in any more detail, please do not hesitate to contact me on T: 02476 181421.

Yours sincerely

Richard Fairholme (by email)
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