



Debra Hawkin  
Regulatory Frameworks  
National Grid  
NG House  
Gallows Hill  
Warwick  
CV34 6DA  
[debra.a.hawkin@uk.ngrid.com](mailto:debra.a.hawkin@uk.ngrid.com)

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Dear Debra

**Re: Discussion Document NTS GCD05: “Options for a SO Commodity Charge for NTS Storage Facilities”**

The Gas Storage Operators Group wishes to submit a response to the above Discussion Document. The Gas Storage Operators Group represents the interests of the UK’s Gas Storage owners, operators and developers. Membership of the Group is open to companies involved in such activities and currently we have 14 members. The current members of the group and signatories to this submission are detailed in Appendix 1.

The Gas Storage Operators Group (“GSOG”) does not support the introduction of a SO Commodity Charge, or indeed any charge designed to recover a proportion of SO Allowed Revenue from storage users.

**General Introduction**

National Grid state that if a Storage SO Commodity charge were to be introduced it may be set at a level to recover around £2.5m. Although GSOG disputes that a charge should be levied at all on cost reflective grounds, we fail to understand the economic rationale for considering a charge designed to recover such insignificant revenues. There is no evidence of market failure in the current regime and as such there is no discernible benefit to the UK Gas Market of introducing this charge.

The Document correctly proposes that storage facilities should be viewed differently from other connections to the NTS. Unlike other connections storage facilities provide “parking services” to users and National Grid insofar as gas which is injected into a storage facility will at some later time be withdrawn and entered back into the Network for delivery to other offtakes. In the Waters Wye Associates report<sup>1</sup> commissioned by GSOG which considered the interaction between NTS and storage facilities a number of observations were made which further legitimises the view propounded by National Grid:

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<sup>1</sup> ‘UK Gas Transmission System benefits from Gas Storage’ Waters Wye Associates, Sept 2007



*“It may be argued that storage is no different to competing providers of flexibility e.g. customers providing demand side response. On this point WWA suggests that the flow patterns exhibited by storage facilities are unique and cannot be easily compared with other offtakes.” and*

*“Storage facilities are more predictable than other system points as they tend to flow directly in response to price signals and therefore demand changes. Other system points will react to any number of variables, most obviously being prices of substitutes, alternative non-UK gas markets and/or complimentary fuels/outputs. Clearly, and again unique to storage flows may occur into, or out of the facilities.”*

The report went further and concluded that storage facilities “do provide a significant benefit to the Transmission System due to the overall proximity of the Facilities to consumer demand thereby reducing the need for pipe and compression capacity between the alternative sources of supply and demand.” Although we understand that the analysis produced in the report centred on TO benefits we believe that it does reinforce the position that storage provides services to the overall network and users, which are not recognised through the current charging methodology. Those services which ultimately result in lower investment levels and lower overall transportation charges imply that National Grid through its charging methodology treats storage as an extension of the NTS as it does not feel it necessary to set TO charges which properly reflect costs imposed by them<sup>2</sup>. In summary, the parasitic relationship between NTS and storage is providing very real and substantial benefits to users and customers as storage is relied upon to operate in a manner which benefits the overall network. It is for this very reason that storage is treated as an extension to the network.

## **Detailed Comments**

In this section GSOG will address the questions posed in Section 6 of the Document.

In relation to Question 1 GSOG will provide an answer at the end of this section after we have considered the other issues highlighted in subsequent questions.

### **Question 2. Which SO costs should be included within a SO Storage Commodity Charge?**

i. Shrinkage: Own Use Gas

National Grid has shown very clearly in its analysis that if a charge were to be imposed on storage users then it will lead to double charging. Furthermore, and again drawing on the analysis produced in the Waters Wye report it is clear that the relative location of storage is likely to reduce the need for additional compression stations to be constructed. As stated in the GSOG response<sup>3</sup> to GCM03 we believe that when the timing of flows to and from storage is considered, rather than flows in aggregate, the conclusion arrived at in the Waters Wye report is correct. The following extract from that response we believe continues to be of relevance:

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<sup>2</sup> This is due to the Transportation Model as supplied to users has a constraint which ensures that both entry and exit charges must be greater than zero (plus a de minimus charge)

<sup>3</sup> Response to Consultation Document GCM03, GSOG Nov 2006



*“During the summer months, when gas is predominately injected into store, a number of entry point flows will be able to move gas into store without the need for compression e.g. Langed flows at Easington, Milford Haven LNG, BBL and IUK at Bacton and Isle of Grain LNG. Elsewhere, at such locations as St Fergus and Teeside the need for compression will be minimized. Conversely during periods of withdrawal, the need for compression again will be minimized due to the proximity of storage facilities to areas of demand. By way of illustration, GSOG estimates that if Peterborough is adopted as a proxy location for the NBP, then over 95% of storage facilities are located within a 100 mile radius of this hub. This compares extremely favourably with other more “remote” entry points such as St Fergus or Milford Haven.”*

In conclusion, the inclusion of Shrinkage OUG in a SO Storage Commodity Charge would conflict with the Licence Objectives to properly reflect costs, as there are no costs, and facilitating competition between shippers, due to double charging.

ii. Shrinkage: Unaccounted for Gas

UAG derives from meter error which may occur at any metered connection to the NTS. Importantly, a number of storage facilities operate a single meter to measure injections and withdrawals. Where a single meter is reading in error i.e. exhibits a bias and that meter is used to measure bi-directional flows then the impact of the error should net to zero implying that UAG should not be targeted at these facilities.

In any case and when considering multi-metered sites, National Grid has displayed through quantitative analysis that there is no relationship between UAG and throughput or storage flows. As a result if a SO Commodity charge is applied to storage users there would be an element of double charging as users flow gas into and out of storage and ultimately onto customers.

As with Shrinkage OUG the inclusion of Shrinkage UAG would fail the Licence Objectives test as costs would not be properly reflected and competition between shippers would be undermined.

iii. Internal Costs

National Grid states that the administration of storage sites is comparable to other NTS supply points/CSEPs. It does recognize, however, that the costs are fixed and would not increase with either an increase in storage facility numbers or utilisation. GSOG has no evidence to dispute this claim, however, two issues need to be addressed when considering the inclusion and application of these costs. Firstly, if the charge were to be based on flows, be that physical or commercial then those sites which cycle facilities frequently will make excessive contributions to the allowed revenue to finance this administrative function. This is due to the simple fact that charges are fixed, irrespective of the utilization of the facilities. As a facility is used more aggressively, for instance filling and emptying more than once every gas year it will attract a level of charges which greatly exceed that of a facility which cycles only once.

Secondly, if storage facilities are considered to be an integral part of the overall network, providing services to users and National Grid alike, as detailed in the earlier commentary of this response, then it would seem inappropriate to penalize those users which access



storage to meet their portfolio requirements. GSOG would argue that the recovery of these costs would be better targeted at the other system points where gas is either delivered or offtaken, rather than parked as is the case with storage. On this point we welcome the analysis<sup>4</sup> provided by National Grid at the TCMF meeting held on 5<sup>th</sup> February 2008 which shows that the imposition of a Storage Commodity Charge would penalize small users increasing aggregate charges by around £300k per annum.

The inclusion of Internal Costs within a Storage SO Commodity Charge would conflict with the Licence Objectives. The charge would not properly reflect costs as costs are fixed and it would not facilitate competition for the following reasons;

- those users which multi-cycle storage would be overcharged; and
- small users would be adversely impacted which will only serve to undermine competition.

iv. Operating Margins and Constrained LNG

There is no evidence to advocate the inclusion of Operating Margins and Constrained LNG within a charge to storage users. There can be no dispute that storage in the UK is used in a commercial manner and will be withdrawn at time of high demand/prices. With this in mind it is clear that storage does not benefit from services which are used to support the system in circumstances where storage users are withdrawing gas.

The inclusion of Operating Margins and LNG would conflict with the Licence Objective to properly reflect costs.

v. Deemed Interruption

As is the case above it would be illogical to impose a cost onto storage users for a service they do not benefit from. Storage users actually provide benefits to the system by utilising interruptible capacity during periods of low demand and provide capacity to the system through the withdrawal of gas during periods of high demand.

The inclusion of Deemed Interruption would conflict with the Licence Objective to properly reflect costs.

vi. Outcome of Incentive Schemes

It is our understanding that the schemes which form part of the overall incentives package include; NTS Shrinkage; Operating Margins; and Residual Balancing and Quality of Information. As discussed above NTS Shrinkage and Operating Margins do not benefit storage users and therefore it would be reasonable to exclude the associated outputs generated via the individual incentive schemes. The Residual Balancing incentive currently consists of two elements; a daily price performance measure; and a daily linepack change. In practical terms the incentives endeavour to ensure that the balancing activities pursued by National Grid are cost effective and do not shift the costs over more than one Gas Day. What needs to be considered is do storage users contribute to the costs associated with Residual Balancing and if they do should they be exposed to any chargeable elements of the incentive schemes?

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<sup>4</sup> 'SO Storage Commodity Charge Impact Analysis Presentation' National Grid TCMF 5<sup>th</sup> Feb 2008



On these questions, GSOG believes that the role of storage should be revisited. As stated previously storage facilities provide a parking service and are for this reason an extension of the NTS network. Users access storage ultimately to manage their portfolio positions and minimize exposure to imbalance risks. National Grid have shown in their Impact Analysis Presentation that as small users would be most deleteriously affected by the imposition of a Storage Commodity Charge then it can be deduced that in relative terms<sup>5</sup> they are the most significant users of storage. In physical terms, users, particularly smaller users, will respond to commercial drivers and withdraw gas when prices/demand is high and inject it when prices/demand is low. This reaction is unique to storage as was pointed out in the Introductory Section of this response. Other potential sources of flexibility will consider other variables such as; prices of substitutes e.g. fuel oil; alternative non-UK gas markets; and/or complimentary fuels/outputs e.g. electricity or crude oil. GSOG believes that the behaviour of storage users provides assistance to the network and overall minimises NG's role as Residual Balancer.

For these reasons GSOG proposes that the Residual Balancing Incentives should not apply to storage users.

In terms of the Licence Objectives, we believe that their inclusion in a Storage Commodity charge would be at variance with the requirements to properly reflect costs and to facilitate of competition.

In terms of the Quality of Information Incentive Scheme this incentive is designed to ensure the timeliness and availability of information required by users and customers. Economic theory asserts that this in turn will lead to efficient operation of the market. GSOG believes that the outputs from this incentive are best targeted at the chief beneficiaries of the information; the users delivering gas to customers. Storage facilities provide information to the market through National Grid to allow all participants to observe the physical operation of the facilities. We would argue therefore that storage users, as customers of the facilities are contributing to the costs associated with the provision of timely and accurate information and should not be expected to contribute to the incentive costs particular to this Scheme.

In terms of the Licence Objectives, we believe that their inclusion in a Storage Commodity charge would conflict with the requirement to properly reflect costs

vii. Under or over-recovery from previous year ('K')

The k mechanism would only be relevant in the event that a level of allowed revenue was to be recovered via a Storage Commodity Charge. On the basis that we do not believe that such a charge should be introduced, this cost component need not be considered.

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<sup>5</sup> It must be that in terms of a source of flexibility the ratio by which small Users use storage when compared to their individual throughput volumes is greater than that exhibited by large Users.



**Question 3. Should the charge apply to physical or commercial flows?**

GSOG does not believe that a charge should be applied; however, we will address this question on its own merits. A number of respondents, including GSOG, to Modification Proposal 0120V identified that the application of a charge to commercial flows was untenable. Ofgem in its Decision to reject Modification Proposal 0120V<sup>6</sup> concurred with this view stating;

*“In particular, by linking the proposed charge to commercial flows (i.e. allocated quantities), these proposals would not result in cost reflective charges.”* and

*“Given the lack of cost reflectivity previously discussed, it could be argued that the proposals are potentially discriminatory towards a certain category of storage users (i.e. those with large commercial flows/high cycling facilities) and might also potentially have a negative impact on competition between shippers.”*

GSOG does not believe that the weight of argument and clear direction provided by the industry and Ofgem in relation to Modification Proposal 0120V and previous Modification Proposals 0532, 0545, 0547 can be ignored and any further consideration of the application of a charge to commercial flows should be rebuffed.

**Question 4. If a charge were based on physical or commercial flows what are the estimated systems costs to Users and the industry? Please give details for the two possibilities.**

GSOG does not believe that a charge should be applied; however, we will address this question on its own merits. The costs associated with introducing a charge based on commercial flows are likely to be minimal as the charges would be based on the users individual allocations. As stated in our response to Question 3, the industry and Ofgem had unequivocally rejected the commercial flow approach and if it is determined that a charge should be applied then it must be attached to physical flows. GSOG has considered the cost implications of introducing this approach and is happy to share its findings.

We have assumed that the storage operators will be required to determine the allocation of the overall charge, based on physical flows, to their customers. In effect the storage facility will be acting as an Allocation Agent for the sole purpose of determining the users share of the overall charge.

Clearly the highest cost element would relate to IS modifications, in particular adding capability to the “Storage Operator Customer Facing Systems” to permit allocations based on shares of physical flow. As well as implementing the functionality to allow for physical allocation, additional reporting functions would need to be established to ensure that storage users are able to properly reconcile charges.

Finally, there would also need to be new interfaces developed between the Storage IS Systems and xoserve which will reconcile Host data with that stored on the Gemini System.

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<sup>6</sup> Decision on Modification Proposal 0120V, Ofgem Jan 2007



We would expect that the development costs associated with the IS work to be between £55k-£65k on average per storage facility.

Other one-off costs might include contractual changes, process changes and staff training which we would estimate to costs between £10k-£15k on average per storage facility.

Finally, in terms of day to day activities we would expect ongoing maintenance charges to be between £10k to £20k per annum per storage facility. These activities would include system support, resolution of reconciliation errors and dealing with customer queries etc...

GSOG estimate that total set-up costs would be between £65k-£85K per storage facility with additional ongoing costs of £10k to £20k per annum per storage facility.

We are unable to estimate the costs incurred by National Grid, but due to the complexity of the changes we would expect them to be significant. We trust that National Grid will be able to provide an estimate of their costs in the final report.

**Question 5. Would it be unduly discriminatory to have a different commodity charge for storage Users?**

GSOG does not believe that a charge should be applied, however, we will address this question on its own merits.

Before addressing the specific concern of this question it is important to establish what is meant by undue discrimination. GSOG believes that the consultation process carried out by Ofcom in June 2005<sup>7</sup> provides some useful guidance on this issue and recommends that the conclusions reached by Ofcom are transferable to gas transportation charging.

Ofcom characterises undue discrimination as follows;

*“Ofcom will consider the capability of any differences (or similarities) in transaction conditions that are not objectively justified by relevant differences (or similarities) in the customers’ circumstances to harm competition.”*

In effect, Ofcom is saying that as long as the circumstances of the customers can be shown to be different and that the effect of the different treatment is not harmful to competition then such a situation should not be regarded as being unduly discriminatory.

If we translate this approach across to the application of a variable SO commodity charge then we suggest the following questions must be answered:

- i. Do storage users exhibit different characteristics to other users?  
GSOG believes that storage users can be classified differently from other users for reasons we established earlier in this response. Unlike other offtakes, storage facilities are not “final use” offtakes as they provide parking services for the gas molecules injected into them by the relevant users. Storage is used by users to meet supply and demand

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<sup>7</sup> ‘Undue Discrimination by SMP Providers – consultation’ Ofcom, June 2005



variations and ultimately to mitigate against imbalance risk. Other NTS system points differ from storage points insofar as they either input or take gas out of the system. This is also true of bidirectional interconnectors which do not redeliver molecules which have previously passed through them and in any case can behave in a uni-directional manner if the operators/users so desire.

- ii. Is the cost of providing services to storage users the same as the cost of providing services to other user?  
GSOG has gone to some lengths in this response to show that the SO costs attributable to storage users are different to those attributable to other users. In fact, GSOG believes that the only cost which may be applicable is that associated with providing administrative services (Internal Costs). That being said GSOG does not believe that this cost should be recovered from storage users and categorically should not be recovered via a commodity based charge.
- iii. Would the application of a variable commodity charge be harmful to competition?  
GSOG does not believe that the application of a charge which properly reflects the cost of the service provision would be harmful to competition.

### ***Question 1. Should storage continue to avoid a SO Storage Commodity Charge?***

GSOG has gone to some lengths to consider the merits of introducing a SO Storage Commodity Charge. Our qualitative and quantitative analyses demonstrate that the charge is invalid and should not be considered further. In summary our objections to the charge are detailed below:

- ? There do not appear to be any persuasive arguments to justify the imposition of a charge. We believe that a change to the charging methodology should only proceed when there is a clear material issue that demonstrably causes an inefficient market;
- ? The proposed level of revenue to be collected through this charge is immaterial and therefore, would not generate any discernible benefit to the UK Gas Market (noting that the reduction in the standard SO Commodity Charge level would be negligible);
- ? Storage Facilities are unique and for charging purposes it is legitimate to treat them differently to other connections. It is entirely reasonable, on regulatory as well as economic grounds, not to impose a commodity charge on storage users;
- ? We do not dispute that National Grid may incur some level of Internal Costs associated with the administration of storage users, however, it is clear that these costs are fixed in nature. The application of a Commodity Charge would be non-cost reflective and discriminate against those users which multi-cycle;
- ? In terms of the remaining cost components GSOG does not believe that they are applicable to storage users;
- ? The costs involved in introducing a Storage Commodity Charge would be material. Excluding the costs generated by National Grid we estimate set-up costs of between £65k-£85k per Facility and an additional per facility ongoing maintenance cost of between £10k-£20k p.a.



We conclude that the imposition of this charge is without merit and runs contrary to National Grid's Licence Charging Objectives.

Yours sincerely

Roddy Monroe  
On behalf of the Gas Storage Operators Group



## Appendix 1

### List of Current Members of the GSOG

**Canatxx**

**Centrica Storage Limited**

**EdF Trading Gas Storage Limited**

**Gateway Storage Company**

**GDF Storage**

**HGSL**

**Ineos Enterprises**

**National Grid LNG Storage**

**Portland Gas Ltd**

**SSE Hornsea Limited**

**Star Energy Group**

**Statoil (UK) Limited**

**Warwick Energy**

**Wingas Storage UK Ltd**