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Dear Andrew

Summary Report And Discussion Document On Entry Capacity Substitution Dated 1 February 2008

Chevron North Sea Limited welcomes the opportunity to comment on National Grid's Summary Report and Discussion Document on Entry Capacity Substitution dated 1 February 2008.

With regard to the questions posed within section 4 of the document (repeated here for clarity in italics), we are pleased to offer the following responses. We would point out upfront, however, that all of our responses are based on the overriding principle that all capacity up to the peak forecast flows identified in the Ten Year Statement should be exempt from substitution.

A. ***Capacity Available for Substitution***

What proportion of baseline capacity should be withheld from QSEC auctions (and substitution) for use in later auctions (the current Licence requirement is 10%)?

Currently 10% of the baseline capacity is withheld from the QSEC auctions and released in the initial eighteen months (548 days) of the AMSEC auction period (eg 10% of the baseline capacity for April 2008 through to October 2009 has only just been released in the AMSEC auction taking place this month). If capacity for a specific quarter has previously sold-out in the QSEC auctions (or been substituted away), this means that the only capacity available to shippers in the AMSEC auction will be the 10% previously withheld.

As a gas producer, as well as a shipper, we are acutely aware of the difficulties in accurately forecasting future gas production rates such that the appropriate quantity of entry capacity can be secured. There is a risk that 10% of baseline

entry capacity may be insufficient for fine-tuning of capacity requirements by producers as production forecasts change, causing gas to be stranded offshore through lack of entry capacity. In our view, it would be more appropriate to retain 20% of baseline capacity for the AMSEC auctions to better accommodate short/medium term changes in gas production forecasts and facilitate new entrants to the market.

Forecast Flows

Should National Grid exclude from substitutions capacity up to the level of forecast (as specified in the TYS) flows?

Yes - we firmly believe capacity up to the peak forecast gas flows identified in the annual Ten Year Statement should be exempt from substitution. To explain why, we would highlight our potential West of Shetland gas reserves.

We are one of a number of companies involved in exploration activity to the West of Shetland where the estimated reserves represent around 17% of the UK's remaining oil and gas[1]. As there is currently no pipeline infrastructure in that area, a joint industry/government group (the West of Shetland Task Force) was formed in November 2006 to find a technical and economic solution which would facilitate development of this area. In the case of the gas reserves, a new export pipeline will have to be constructed with St Fergus being the landing point.

Prior to project sanction, it is not viable for us to make the financial commitment necessary to procure entry capacity for West of Shetland gas through the QSEC auction process. As with any exploration activity, the uncertainty envelope on the potential reserves, production levels and timing is still too wide. However, we can (and do) provide forecast data for this gas through the "Transporting Britain's Energy" (TBE) process which feeds through to the Ten Year Statement.

If capacity up to the peak forecast flows identified in the Ten Year Statement is exempt from substitution, it would be "protected" until we are in a position to procure it, thereby ensuring our potential West of Shetland gas reserves do not become stranded due to lack of entry capacity.

Would this have an adverse impact on the quality of data provided in the Transporting Britain's Energy process which feeds into the TYS?

We see no reason why this should have an adverse impact.

Would an alternative limit be appropriate?

No - we firmly believe that the appropriate limit is the peak forecast gas flows identified in the annual Ten Year Statement.

[1] Source: BERR Oil and Gas website www.og.dti.gov.uk/UKpromote/wos_task.htm

Single Quarter Problem

Where capacity is currently booked at an ASEP for a single quarter in the future should this prevent capacity at that ASEP, to the level booked, being available for substitution in the period prior to that booking?

No – If capacity is only booked at an ASEP for a single quarter in the future, then capacity at that ASEP should be available for substitution as if the single quarter booking does not exist.

If yes,

what about two quarters?

It would appear reasonable that capacity at an ASEP should be protected from substitution if capacity bookings have been made for a minimum of four quarters over two consecutive years in the future.

should rules be introduced to prevent short-term, distant, bookings in future QSEC auctions?

It would appear appropriate to introduce rules to prevent short-term (ie less than four consecutive quarters) distant bookings for capacity.

Should the substitution of capacity be time limited, i.e. substituted capacity reverts back to the original ASEP after a set period?

No - if future capacity bookings dictate that additional capacity is required at the original ASEP, then the release of incremental capacity through either substitution or investment should be considered and evaluated at that time.

Should a mechanism be established to allow Users to surrender capacity, i.e. similar to that proposed for Transfer and Trades but for a distant time frame?

This is a sensible suggestion as it would help to minimise capacity sterilisation. As we noted earlier, it is not always possible to accurately forecast gas production ahead of time with the result that shippers who are also producers may end up holding surplus entry capacity. The introduction of a surrender mechanism for a distant time frame would allow that capacity to be used more efficiently.

B. ***Lower NPV Test***

Considering the complexity of potential solutions, should different User commitment tests be applied for incremental capacity satisfied from substitution and from investment?

Our view is that one test should apply for the release of incremental capacity, irrespective of whether it is satisfied through substitution or investment, as the value of that capacity is identical in both cases. However, any such test must take into account the full impact and opportunity cost of any incremental capacity released.

If yes, how should a dual-test be implemented?

N/A.

If yes, what should the "substitution test" be (as a percentage of NPV or other alternative)?

N/A.

Combined Substitution / Investment

In the event that incremental capacity is able to be released as a result of a combination of substitution and investment what test should be applied to trigger capacity release?

In our view the same test should apply to both substitution and investment, subject to the caveat above.

Competing Bids for Substitutable Capacity

Where capacity available for substitution is limited and a lower NPV test applies, how should such capacity be used?

N/A.

Where there are two or more incremental capacity requests that only satisfy the lower (if any) substitution test what rules should apply to prioritise requests? Should this be based on the relative NPV of the relevant bids? Are there any alternative measures that could be used?

N/A.

Should capacity be substituted to support incremental capacity requests satisfying the investment test only after consideration of those requests that only satisfy the lower (if any) substitution test? Or vice versa? Or should the same rules applying above apply to all requests?

N/A.

C. <u>Exchange Rate Cap</u>

To avoid excessive capacity destruction should capacity substitutions be prohibited if the exchange rate exceeds a specified value?

Yes - we believe it is imperative that capacity substitution does not cause significant destruction of aggregate baseline capacity.

If yes, what should the cap on exchange rates be?

A low exchange rate cap would be appropriate (certainly much lower than the 10:1 upper limit proposed for capacity Transfer and Trades) but it is difficult for us to assess what the exact cap should be given the information available to us.

D. ***Availability of Capacity for Substitution***

Assuming that substitution will be triggered by User bids submitted in the QSEC auctions for which capacity can be requested from 18 months ahead (e.g. April 2009 QSEC for October 2010 release) but substitution is intended to minimise investment (42 month lead time – October 2012 release) should National Grid substitute capacity to release incremental capacity ahead of 42 months?

If peak forecast flows are used to determine the amount of substitutable capacity then this would appear to be a sensible idea.

If yes, should any limit be placed on the timing of such release, e.g. 18 months, 30 months?

If peak forecast flows are used to determine the amount of substitutable capacity then we would be comfortable with National Grid releasing incremental capacity through substitution two years ahead. For example, capacity bid for in the April 2009 QSEC auction could be released in April 2011. Users will have had the opportunity to bid for capacity up to that point in earlier QSEC and AMSEC auctions.

If yes, should any measures be taken to protect (some/any) capacity at donor ASEPs?

The use of peak forecast flows to determine the amount of substitutable capacity should offer sufficient protection.

Should substitution be limited to single donor ASEP or should combinations (substituted at different times) be allowed? All but the last would be time limited substitutions, e.g. Donor ASEP A used from year 2 to 4 but not available after year 4, donor ASEP B used from year 5.

Although we can envisage a situation where substitution using a combination of ASEPs could make more efficient use of the available infrastructure capacity, this could make National Grid's network modelling even more complex, and potentially less transparent, than it is at present.

E. *Other Issues*

Alternative Economic Test / User Commitment

We would need more details of any alternative test(s) before we could answer the four questions below. We would reiterate our earlier point, however, that any test used must take into account the opportunity cost and full consequences of any incremental capacity released.

Would Users support replacement of the current NPV test to trigger release of incremental capacity (irrespective of substitution)?

What alternative tests, e.g. four year booking commitment, would be appropriate? Should different categories of entry point be treated differently, e.g. storage?

How should substitution and investment be distinguished (if at all) under any alternative test?

Ideally, when should an alternative test be introduced; i.e. for April 2009 QSEC or Sept 2008 QSEC or later?

New Entry Points

Do respondents consider that undertaking separate QSEC auctions for new ASEPs is unduly preferential? Are there any discrimination issues?

It would appear sensible for a separate QSEC auction to be held for any new ASEP provided the introduction of the substitution obligation is aligned to a regular QSEC auction.

Should the timing of the introduction of the substitution obligation align to a regular QSEC auction where all Users have access in respect of all ASEPs?

Yes – it would be unreasonable for shippers at a new ASEP to be able to access "substitutable" capacity prior to shippers at existing ASEPs. For example, if the current Ofgem consultation process results in baseline capacity at an existing ASEP being increased, that additional capacity would be vulnerable to being substituted away to a new ASEP (before Users at the existing ASEP have a chance to bid for it) if the substitution obligation is not aligned to a regular QSEC auction.

Bearing in mind that these auctions could trigger the release of significant quantities of incremental capacity at new ASEPs, should substitution be excluded from these auctions?

Not necessarily, provided:

(i) the introduction of the substitution obligation is aligned to a regular QSEC auction; and

(ii) peak forecast flows at existing ASEPs are used to determine the amount of substitutable capacity.

Reserve Price Discounts

Notwithstanding the May 2007 discussion, do respondents support removal / relaxation of the reserve price discounts?

We would need a greater understanding of the implications of changing the current reserve price discounts before we could express an opinion on this issue.

Other Issues

Respondents should not limit their comments to the above questions. National Grid encourages respondents to raise any additional issues that require consideration prior to implementation of the substitution processes.

In particular, we would be interested in people's thoughts as to how the substitution process may impact upon other elements of the entry capacity regime.

Given the complexity of the issues detailed in National Grid's Summary Report and Discussion Document, we believe that stakeholders need more time to fully consider the implications of the substitution proposals. Delaying the introduction of the substitution obligation such that it is aligned with the 2009 QSEC auction would allow an appropriate consultation phase to be undertaken and would also enable stakeholders to fully evaluate the effect of other recent changes to the entry capacity regime (adjustment of baselines, capacity Transfer and Trades, reduction in capacity withheld from the QSEC auctions, etc).

Additionally, there should be provisions to review and adjust the eventual substitution processes if they are found to "mechanistically" produce a recommended course of action which is clearly not the optimum one.

We hope that you will find these comments useful.

Yours sincerely

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