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Att: Andrew Fox

Your ref.:  
Our ref.: DB22-BY.KB-08.13995

Bygnes, 2008-08-04

**RE: Entry Capacity Substitution Methodology Statement - Discussion Document July 2008**

Dear Andrew

As a consequence of the Special Condition C8D of National Grid Gas plc's Transporter Licence an entry capacity substitution methodology statement is to be prepared following consultation with relevant shippers and interested parties.

Gassco as a connected system operator could be seriously impacted by the methodology as proposed and wishes to make its' views known. We would like to make comments of a more general nature in addition to responding to the specific questions raised in your statement.

Gassco has a very similar role to that of National Grid in that it operates the Norwegian offshore transmission system for natural gas of sales quality but differs in one aspect in that it has no ownership interest in the infrastructure and therefore has no incentive to accede to the building unnecessary assets.

However, as the transporter of significant gas supplies to the European and UK markets it is beholden upon Gassco to ensure that deliveries of shipper's gas are reliable at all times. To this end there is flexibility built into the pipeline network, which offers the potential to provide alternative gas sourcing strategies, albeit more limited at peak, from each of the 50 plus connected fields on the Norwegian shelf. This is considered to be efficient and prudent operation which is provided at low cost yet offers flexibility and optionality to the transporter and it's shippers.

With the energy prices being so high there are currently many projects under consideration which were previously related to non-viable hydrocarbon deposits but are now becoming economically viable together with new frontier areas being developed.. Many of these projects will not come to a final decision point until 2010 or thereabouts. It therefore seems premature to substitute capacity from important terminals which have a significant role in enabling future imports at this point in time, particularly when it has been demonstrated that the exchange rate for capacity could be very destructive and cause the National transmission System to shrink considerably.



Furthermore, in the UK the cost of any future capacity investment is believed to be considerably below 5% of the existing asset base. Today the cost of transportation represents only 2% of the wholesale gas price and therefore the effect of future capacity investment on transportation costs are less than 0.1% of the cost of wholesale gas, which at today's prices represents <<0.1 p/therm on the cost of gas to the end user. This is a low cost for the implied flexibility and optionality that it provides.

With the above in mind it is Gassco's view that the introduction of Substitution should be shelved until these significant future developments have been concluded upon and the basis of the next phase of gas supply to the UK become clearer.

The undertaking of an impact assessment is also to be decided. There are many changes in the gas market underway and many more to be decided. Substitution is only a small part of this change. It is in our view important that a full impact assessment is undertaken to assess the consequence of substitution of entry capacity on all of the foreseen developments taking into account projects, supply sources and regulatory change. A full and proper impact assessment should be completed prior to final decisions being made in respect of substitution of entry capacity.

Under the terms of the Unified Network Code, National Grid continues to have an obligation to act as a Reasonable and Prudent Operator. How does the National Grid's stringent interpretation of the new Licence Condition sit with this obligation? Furthermore National Grid is to act in an economic and efficient way but does the elimination of flexibility and the shrinking of their transportation network achieve this end or is it contradictory?

Our response to each of the questions posed is attached but we urge that substitution is not introduced prematurely to the detriment of supply flexibility in the UK gas market.

Yours sincerely

A handwritten signature in black ink, appearing to read "Thor Otto Lohne".

Thor Otto Lohne,  
Vice President Finance and  
Commercial Development

A handwritten signature in black ink, appearing to read "David Turner".

David Turner  
Adviser



## Entry Capacity Substitution Methodology Statement – Discussion Document July 2008

Gassco's response to each of the National Grid Gas questions:

### Question 1

National Grid's interpretation of the requirement to substitute entry capacity without restriction before making further investment in capacity is clearly an extreme interpretation. Having no regard to the effect on capacity destruction and the shrinking of the transmission system has a severely damaging impact on the attractiveness of the UK for short term gas in the immediate future as well as in the longer term, gas requiring investment in connected systems. The Interconnector from Zeebrugge and the Vesterled pipeline from Norway both experience short term capacity bookings in order to deliver swing gas when the UK is the most attractive market. If due to substitution there is no entry capacity available into the UK at Bacton or St Fergus then this practice could stop or create a significant upward pressure on gas prices.

There has been much debate on the effect unrestricted substitution would have on potential developments west of Shetland and on the new frontier areas on the Norwegian Shelf and in the Norwegian Sea. The exchange rate is already known to be as high as 9 : 1 for a modest increase of entry capacity at Easington. Thereafter, the capacity exchange rate is assumed to increase as more extreme terminals are robbed of their unbooked capacity.

Without doubt the loss of flexibility by not investing and moving further towards a more constrained system will increase the risk of a failure to supply. This is particularly so if the constraint is exacerbated by the loss of a terminal or a pipeline into a terminal or a compressor station onshore. This should be analysed and risk assessed before substitution commences. Furthermore the consequence of having no available entry capacity on gas commodity price should be studied and evaluated.

### Question 2 and 3

The test and lead times for substitution of capacity should be no less stringent than that for the booking of primary capacity which is subject to investment.

### Question 4

Gassco would not encourage a methodology which ignores the data provided under the TBE process when there are already independent checks and balances applied before the data solicited through the TBE process is used. These checks should help to identify overstated quantities. If the alternative is to ignore potential new connections and substitute away entry capacity this will as stated above render the UK a less attractive market due to the additional risk incurred.

The argument of that investors in potential new connections should book long term capacity ahead of finalising investment decisions for their projects is just not practical particularly when alternative competing solutions require no such early capacity commitment.

Similarly shippers at existing entry points that wish to use capacity on a limited number of days each year to ship swing gas into the UK market would not be able to justify the booking of long term capacity. Furthermore an unintended consequence of substitution is that the capacity of the upstream connected pipeline could become downgraded to the available firm entry capacity remaining at the UK entry point thereby shrinking connected systems as well as that of National Grid.



#### Question 5

National Grid should address the issue of the booking of a single quarter at the outset. This is a key issue which should be decided before submitting the Methodology Statement since this continues to be a major risk to future connections. If this is to be prevented then all parties should be aware before decisions are made on the rules for substitution.

#### Question 6

No comment

#### Question 7

The list of donor entry points in their sequence is welcome but without knowing available capacity at each and the capacity exchange rates a false impression may be given. For example St Fergus is low on many of the lists but may be the hardest hit target due to unavailable capacity at many locations and poor exchange rates at other closer donor entry points. The whole concept of substituting entry capacity at St Fergus to a proposed location in Wales or the south of the UK in Gassco's opinion does not warrant consideration.

#### Question 8

Providing National Grid with discretion to select the optimum donor mix seems appropriate but assurances on how that discretion is used would be necessary. Would National Grid be audited on this process as there are likely to be alternatives they could choose? Also could they be conflicted in their decision if they remain investors in storage facilities.

#### Question 9

There must be an exchange rate cap if capacity destruction is to be avoided. Initially an exchange rate of 1 : 1 or a rate very close to this should be the limiting factor until future projects are more decided upon and can be taken into consideration prior to the substitution of entry capacity.

The National Grid example of 9: 1 to provide additional capacity at Easington is already excessive and will only become worse as capacity is substituted from more distant locations. This cannot have been the intention when the concept of capacity was first mooted.

#### Question 10

No comment

#### Question 11

Agree that substitution should not take place until shippers at that entry point have had an opportunity to book available capacity. This includes new ASEPs



## Question 12

There should be an exchange cap which is close to 1. Possibly also consider time limiting the arrangement until the significant offshore developments which are already in the known are decided upon. A permanent solution should not be agreed until the negative effects are better understood, in particular the second and third stage substitution effects.

In addition there should be an impact assessment undertaken on the effects of substitution. It has not been fully explained to the industry what the ultimate consequences would be beyond one example shown at the workshop on 11<sup>th</sup> June 2008. The impact assessment should also look at the wider picture and not be limited to this one aspect when there are many changes about to take place in the UK gas market.

The consequence of National Grid not investing until all available un-booked capacity has been substituted elsewhere will have serious consequences on available linepack. Their ability to access it quickly in an emergency and manage an incident has not been explored. As a Reasonable and Prudent Operator this should be examined and the additional risk to security of supply disclosed.