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Dear Andrew

Entry Capacity Substitution Methodology Statement: Informal Consultation

BP welcomes the opportunity to comment on the new set of National Grid's Entry Capacity Substitution proposals.

Although BP agrees with the general principals of substitution in enabling National Grid to manage the NTS more effectively, BP feels that the current base methodology would lead to excessive capacity destruction and unnecessary system constraints¹. By removing flexibility from the market, both competition and supply security will be seriously harmed. Therefore it is necessary to place limits on the capacity available for substitution. In placing these limits we support the use of the Mechanical Approach. For clarity, BP does not support the Two Stage Auction or Options Approach.

Mechanical Approach

The Mechanical Approach best achieves the objective of placing the appropriate limit on substitution to avoid excessive capacity destruction. The approach is both simple and uses data from an already well established process (TBE). National Grid's use of the source for a number of years in scenario planning further supports the utilisation of this information.

Importantly, the mechanical approach is also the only option to take into account LNG and storage deliverability rates, and thereby recognises the different commercial strategies and short term capacity needs of these facilities. The mechanical approach would also include trading activities at entry points such as the Interconnector. Without this recognition supply security could be damaged as gas may not be able to flow onto the NTS when it is needed the most.

¹ Please refer to BP's previous Entry Capacity Substitution Methodology Informal Consultation response from August 2008 for details.

In contrast to the mechanical approach, both the Two Stage Auction and Options Approach generate a number of unnecessary complexities and financial burdens, which are likely to impact both the competitiveness and flexibility of the GB gas market. A particular concern regarding the Options Approach is the high level of uncertainty that the mechanism will create. If one shipper buys an option, this will have a knock-on effect on other donor ASEPs down the selection chain. This makes it impossible to predict if your capacity is in danger, without a shipper having to buy an option on all its 'possible' future capacity requirements – a security which is only valid for one year, and simply protects the capacity from substitution. The issue arises because no shipper can know what all other shippers taking part in an auction are likely to bid for and also what impact this may or may not have on their capacity requirements – leading to inefficient buying strategies. The same uncertainty exists for the Two Stage Auction approach but the result is arguably even worse, as the financial outlay is not simply the price of an option but the total value of the capacity itself.

If the two stage auction process is combined with the credit arrangements proposed by Modification proposal 246 and its variants, buying long term capacity will be reduced to just a few days. This situation arises as at first the two stage approach reduces the number of bid windows, so that the two stages can be accommodated in the appropriate timeframe, while the Mod 246 credit arrangements seek further time to assess a shipper's capacity position in relation to their credit limit. The result would be an unsuitably short number of bid windows for the QSEC auction to take place, which would be to the detriment of the efficiency of the auction process.

National Grid has also admitted that the proposed option fee for the Option Approach is "somewhat arbitrary". If an option is to be set arbitrarily and in line with what may "seem reasonable", we very much doubt the efficiency of using such a mechanism. In fact it would be highly complex to design fitting options that align with the value that is placed on specific capacity by a specific user – rendering the use of options for the purchase of purchasing or 'reserving' entry capacity as inappropriate.

Reliable Data Collection

Aside from the use of TBE data, BP supports the use of deliverability data as a suitable alternative to where TBE data is limited – primarily for the use of storage sites and LNG importation terminals.

Deliverability data is required for storage sites not only because they are currently generally excluded from the TBE process, but also because the commercial setup of a site differs to other facilities on the NTS. Storage relies on shorter term capacity to be able to react to the price signals in the market – without the protection given by deliverability data this capacity could be substituted away, as it is often picked up in the short or medium term. Enabling deliverability data to be used would also aid in developing the necessary investment climate for storage sites; gas storage is a vital pillar in security of supply as the dynamics of the GB gas market evolve.

National Grid also correctly identified that the current aggregation and distribution of flow requirements data for LNG terminals results in some terminals having their peak requirements understated. This is why we would also support the use of deliverability data for LNG importation terminals.

In order for the Mechanical Approach to be successful, National Grid will need to both actively widen the TBE process as well as revamp the questionnaire to improve the quality and accuracy of data captured. BP suggests creating a workgroup that would analyse the current and potential future shortcomings of the TBE process in relation to its use for entry capacity substitution.

National Grid's concern that forecast values could incentivise stakeholders to overstate their TBE data, and thus devalue the TBE process, does not align with the Shipper standard licence condition 3.3:

“The licensee shall not knowingly or recklessly act in a manner likely to give a false impression to a relevant transporter as to the amount of gas delivered by the licensee on a particular day to that transporter’s pipe-line system...”

The obligation clearly requires the shipper to provide accurate delivery data to National Grid, including for the TBE process. In fact, with the introduction of the mechanical approach, and an improvement of the TBE questionnaire, it will enhance the quality of data produced. This will also be of direct benefit to National Grid, as they can use this data to enhance their scenario planning as part of TBE.

Exchange Rate Cap

As we have already made clear in our previous Entry Capacity Substitution response in August 2008 we do not support the application of exchange rate caps. Setting such a rate would be arbitrary and discriminatory. So long as users provide the necessary data in the TBE process, and it is used appropriately by National Grid, then any of the 90% baseline capacity that remains should be deemed as “unwanted”.

However, BP does see merit in temporary ‘softening’ measures, of which an exchange rate cap would be a practical solution. It would provide a useful soft landing while shippers adapt to the new entry capacity requirements and the collection of TBE data is further enhanced to ensure maximum accuracy and usability. The cap could initially be set at 2:1, before incrementally rising and then finally removed.

10% of Baseline Capacity

Important in designing the substitution process is the preservation of the 10% of baseline capacity held back at ASEPs for short term users. In the TPCR Updated Proposals document of September 2006 Ofgem state that their intention is to “remove the concept completely as part of the next price control review”. However, National Grid rightly recognises short-term shipper capacity requirements, including the “valuable supply flexibility” this can provide in high demand periods. Further competitive and supply security benefits are provided by this type of capacity in enabling smaller shippers and new entrants to secure additional supplies for the GB market. In terms of the Mechanical Entry Capacity Substitution approach, both long term capacity projects and some marginal gas fields will be included in the process, but short term players who rely on the 10% baseline capacity will not. Therefore the introduction of substitution, and the mechanical approach, does not justify the removal of the 10% short term capacity obligation in the next or any subsequent price control review. In fact the 10% capacity held back complements the mechanical substitution process in recognising the diverse needs of shippers, and thereby enhancing GB’s security of supply.

Please do not hesitate to contact me if you have any questions.

Yours Sincerely,

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