

## **Response by Oil & Gas UK to National Grid's Informal Consultation about the Substitution of NTS Entry Capacity**

Oil & Gas UK which is the representative body for the offshore oil and gas exploration and production industry in the United Kingdom has pleasure in replying to National Grid's informal consultation about the substitution of NTS entry capacity.

We have not attempted to answer all of the questions in detail, because there are others better able to do this than we are. We have, therefore, confined our answers to the broader matters under consideration, although we have followed the generality of the questions posed.

It is, however, worth beginning by making four, high level points which are not covered by NG's questions:

- i) it will be essential for substitution, by what ever means it occurs, to be considered in conjunction with the other components of the entry capacity regime; it should not be treated in isolation;
- ii) there should be more information published by NG about the possibilities for new capacity at entry points, with times and costs for providing such new capacity;
- iii) currently, all market participants are dependent on NG's calculations; this is not sustainable and an independent audit is required;
- iv) an impact assessment should be undertaken by Ofgem, taking into consideration all aspects relating to entry capacity, not least NG's current proposal to re-use one of the NTS's main feeders from St Fergus for the purposes of carbon capture and storage projects.

We now turn to the questions posed in NG's consultation document.

### *Paragraph 28*

- a. *Are there any other factors that National Grid should include in the Base Methodology?*
- b. *Are there any aspects of the Base Methodology that should be excluded or amended?*

We are not convinced that the 1 in 20 peak day test for security of supply is, on its own, adequate in these circumstances. We suggest that a longer period should also be considered, such as a peak month or even a 1 in 50 winter. Furthermore, the outcome of the current review of the European Directive relating to the security of natural gas supplies will have to be taken into account, especially if the "N minus 1" requirement for major infrastructure remains as proposed.

Achieving security of supply requires varying degrees of flexibility in the NTS. Ineluctably, substitution will tend to do the opposite.

### *Paragraph 52*

- c. *Should the substitution methodology use an exchange rate cap to limit the impact of substitution on donor ASEPs?*

We support exchange rate caps, especially in the earlier years of substitution, with a review after the benefit of several years' experience has become available.

- d. *Would the intended benefits of an exchange rate cap be better achieved through implementation of any of the options (Mechanical Approach, Option Approach or Two-Stage Auction) discussed in Section 6?*

In principle, exchange rate caps should apply to all options, in order that NTS entry capacity is not un-necessarily degraded, although it seems likely that caps will be more applicable to the mechanical approach than the others. Nonetheless, practical experience of substitution should guide such decisions, in order to prevent any unintended consequences.

*If an exchange rate cap is used:*

- e. *At what level should the exchange rate cap be set? Respondents may consider that a different value is appropriate depending upon other factors of the methodology, e.g. whether any of the options discussed in Section 6 is implemented.*
- f. *Notwithstanding that National Grid is obliged to review the substitution methodology on an annual basis, should the exchange rate cap be set at a low level in the expectation of increasing in future years?*

Begin with 1:1 and only allow higher rates in the light of experience and, even then, consider using a zonal approach. Exchange rates above 4:1 should not be allowed.

#### *Paragraph 59*

- g. *Do respondents consider that an economic test is appropriate or necessary for the substitution methodology?*
- h. *Would an economic test add unnecessary complexity to the process?*
- i. *What benefits, if any, would an economic test provide?*

*If an economic test was introduced*

- j. *What parameters should be used for the donor and recipient ASEP values?*
- k. *Are there any alternative tests that should be considered?*

It is difficult to see how an economic test would work without undue complexity. Perhaps it would be better if a degree of discretion were to reside with Ofgem (and maybe also DECC) in considering what should be deemed "economic and efficient" and in order to protect the national interest with regard to the overall security of gas supplies.

#### *Paragraph 80*

- l. *Do respondents prefer the Mechanical Approach over the Option Approach and/or Two-Stage Auction? Why / why not?*
- m. *What features of the Mechanical Approach do respondents like / dislike; e.g. simplicity, lack of User commitment?*
- n. *What criteria should National Grid use to determine the level of protected capacity at each category of ASEP (e.g. beach terminal, storage etc)?*
- o. *Is the use of deliverability, or similar, such that substitution is limited to major beach terminals acceptable? Would this be undue discrimination?*

- p. *Are there alternative sources of data to the TBE, deliverability that would be reliable, transparent and readily available?*
- q. *How could a soft-landing be applied to the Mechanical Approach?*

Oil & Gas UK sees merits in the mechanical approach, partly because of its simplicity and partly because it relies on information gathered through the annual TBE process. However, this does mean that National Grid would need to cast a wider net when collecting TBE data. As we have noted before, there are more exploration and production operators offshore than there were – the same is true onshore for storage – so a more comprehensive process would be required to ensure proper coverage of market participants.

The principal difficulty with auctions (and potentially options) is that, as we have noted before on many occasions, they do not tell the whole story. There will always be companies who, for a variety of understandable reasons, are not able to make the necessary financial commitments. Forcing companies to lay out substantial sums in advance inevitably will tend to favour the larger, cash rich companies and lead to less competition in the market. This natural reluctance with respect to auctions should favour a mechanical approach to substitution.

*Paragraph 94*

- r. *Do respondents prefer the Option Approach over the Mechanical Approach and/or Two-Stage Auction? Why / why not?*
- s. *What features of the Option Approach do respondents like / dislike?*
- t. *Bearing in mind the substitution objectives do respondents believe that it is appropriate that capacity can be protected from substitution with only a relatively small commitment from the User?*
- u. *Should the Option Approach be made available to non-Users? If so how should it be applied?*
- v. *Is the option fee set correctly?*
  - i. *Is it correct to have the same fee for all ASEPs?*
  - ii. *Are the minimum reserve price and 8 year period appropriate parameters for setting the option fee; i.e. is a fee set at approximately £300,000 for 10 mcmd correct?*
  - iii. *Are refunds in the circumstances described appropriate?*
- w. *Should the option fees and refunds be dealt with through TO charges? If not, how should they be accounted for?*

We prefer the mechanical approach, for the reasons given in our answer above, although we can see merit in providing a degree of optionality. Maybe options could be used in conjunction with the mechanical approach.

*Paragraph 106*

- x. *Do respondents prefer the Two-Stage Auction over the Mechanical and Option Approaches? Why / why not?*
- y. *What features of the Two-Stage Auction do respondents like / dislike?*
- z. *Bearing in mind the substitution objectives, do respondents believe that it is appropriate that capacity can only be protected from substitution if the Shipper makes a commitment to buy the capacity?*
- aa. *Do respondents consider the timeline to be an issue, e.g. would five (or less) stage 1 auction bid windows create a problem?*
- bb. *Bearing in mind the level of commitment required, do respondents think that this proposal would encourage Shippers to obtain capacity for a discontinuous quarter (see section 7.1)? If so, is this a problem?*

Two stage auctions potentially have merits, but they will be time consuming and they will require substantial financial outlays, neither of which is beneficial. Furthermore, as noted above (ref para 80), they may well not tell the whole story. However, perhaps they could also be considered in conjunction with the mechanical approach.

*Paragraph 117*

- cc. Do respondents believe that single quarter bookings present a problem that requires specific rules to prevent them?*
- dd. Would single quarter bookings only be a problem with a specific substitution methodology, if so which?*
- ee. What is the preferred action, if any, to prevent single quarter bookings?*

Much will depend on the outcome for substitution. If the solution is reasonably simple and workable and does not introduce discrimination between parties, there should be no need to do anything. However, if it becomes a problem needing to be solved, it is likely to be an indicator that the substitution method is not working properly.

*Paragraph 124*

- ff. Do respondents believe that the substitution methodology should only allow substitution to proceed where an incremental signal can be met fully from substitution?*
- gg. Should partial substitution be allowed for specific options outlined in Section 6?*
- hh. Should partial substitution be considered as an element of a soft-landing to be introduced at a later date?*

We are not in favour of partial substitution. It would be an undue complication.

*Paragraph 129*

- ii. Do respondents believe that the use of entry zones in the substitution methodology is appropriate? or*
- jj. Should the methodology be applied purely on nearest donor ASEP?*
- kk. Do respondents favour pro-rating within zone?*

The use of entry capacity zones should be considered (ref our answer to questions e and f above).

*Paragraph 139*

- ll. Whether respondents favour a soft-landing?*
- mm. If so, what parameter(s) should be used?*
- nn. Over what period should a soft-landing apply?*
- oo. Are there any other ways that a soft-landing could be introduced?*
- pp. Should a transitional rule be included to ensure that substitution is introduced first to a regular QSEC auction?*

We favour a “soft landing” and learning through experience (ref our answers to questions c, d, e and f above).

*Paragraph 143*

- qq. Notwithstanding the current position, National Grid would welcome views on whether proposals should be put forward to amend the Licence to facilitate a pricing structure which incentivises long term entry capacity bookings.*

On the face of it, this might seem sensible, but we would recommend caution. At present, Ofgem and NG expect users to signal their requirements through auctions, but there is not always enough incentive to book long term entry capacity, especially at St Fergus. Therefore, before making any changes, this would need to be examined in some detail for the potential implications.

*Paragraph 163*

*rr. Do respondents have any concerns or comments regarding aspects of the Base Methodology not discussed above?*

We have two other points to make, namely:

- i) we support periodic reviews of how substitution is working in practice – learning by doing is likely to lead to the best outcome in the longer term;
- ii) there should be fall-back provisions to allow Ofgem and DECC the ability to ensure that the national interest with regard to security of supply is being safeguarded.

Finally, we would draw your attention once again to the four high level points which we have made at the beginning of this reply.

\* \* \* \* \*

Copy: Simon Toole, DECC  
Steve Smith, Ofgem  
John Havard, DECC  
Stuart Cook, Ofgem  
Peter Kershaw, DECC