



4 June 2009

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Dear Andrew

Informal Consultation On Entry Capacity Substitution

Chevron North Sea Limited welcomes the opportunity to comment on National Grid's Informal Consultation on Entry Capacity Substitution dated 15 May 2009.

As a member of Oil and Gas UK¹, we would firstly like to confirm our support for the views expressed in their response to this Consultation. We would also like to express our appreciation for the significant amount of work National Grid has done on this subject to date.

In summary, we are in favour of the Mechanical Approach outlined in the Consultation document for the reasons outlined below. We are not supportive of the Option Approach or the Two-Stage Auction. Note that we have not provided answers to every specific question posed within the Consultation document but have instead commented more generally on the subject matter.

Two-Stage Auction

As we have stated in our previous responses on this subject, we are one of a number of companies currently involved in exploration activity to the West of Shetland where the estimated reserves represent around 17% of the UK's remaining oil and gas².

We do not agree with the potential argument used by some parties that if capacity is unsold it means it is unwanted and hence can be substituted away without any constraints to another ASEP. To use West of Shetland gas as an example, it is not commercially viable for companies such as ourselves to procure entry capacity for this gas prior to project sanction. As with any exploration activity, the uncertainty envelope on the potential reserves, production levels and timing is wide. It is only as progress is made towards the development phase of a project that it becomes feasible to make the financial commitment necessary to procure entry capacity through the QSEC auction process.

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For that reason we are not supportive of the Two-Stage Auction. Even if we were offered a second opportunity to procure capacity at St Fergus to prevent it being substituted away in order to satisfy an incremental signal elsewhere, it would not be commercially viable for us to do so prior to project sanction. The subsequent creation of incremental capacity at St Fergus post project sanction, even if theoretically possible, may not be technically possible at that time due to constraints elsewhere on the network. We therefore perceive a risk that the Two-Stage Auction could result in West of Shetland gas reserves becoming stranded due to lack of entry capacity at St Fergus.

Option Fee Approach

We are also not supportive of the Option Fee Approach, primarily due to its complexity and the fact that National Grid's own data indicates that a single quarter booking would actually be more economical at certain ASEPs (on the basis of the option fee currently proposed).

Mechanical Approach

In determining the amount of substitutable capacity available it would seem short-sighted to focus solely on known user commitments (ie booked capacity), ignoring market intelligence of future field developments. Taking that into account, we are firmly of the view that only capacity above the peak forecast flows determined through National Grid's Transporting Britain's Energy (TBE) process should be available for substitution. For that reason, and for its simplicity and ease of implementation, we are in favour of the Mechanical Approach outlined in the Consultation document.

We do not share the concerns expressed by some parties that this approach could incentivise contributors to the TBE process to overstate future flows at particular ASEPs and hence undermine the value of the process. Gas producers like us put a significant amount of technical effort into producing the data used in the TBE process and individual contributions can easily be cross-checked by National Grid using independent industry sources and market intelligence to ensure the data is in the right ballpark.

Other Issues

We believe it is imperative that entry capacity substitution should not result in significant destruction of aggregate baseline capacity and that the key to this lies in the use of appropriate exchange rate caps. National Grid have now presented a number of examples where the use of high exchange rate caps would destroy large quantities of capacity over many donor ASEPs in order to create a fraction of that capacity at just one recipient ASEP.

To prevent excessive capacity destruction and to help avoid other unforeseen consequences, there must be a "soft-landing" introduction of entry capacity substitution including the use of 1:1 exchange rate caps (ie substitutions should not be permitted where the capacity substituted away from a donor ASEP is greater than the amount of capacity created at the recipient ASEP).

We note National Grid's request for views on whether proposals should be put forward to amend the Licence to facilitate a pricing structure which incentivises long term entry capacity bookings. We would welcome such proposals which would seem to support a key aim of the latest Transmission Price Control Review, namely to encourage Users to signal their capacity requirements in long term auctions.

Ofgem Impact Assessment

Given the complexity and lack of transparency in National Grid's network model, it is quite possible that implementation of any of the three approaches outlined in the informal Consultation document could lead to unexpected and unintended consequences. This is particularly true when the implications of other recent changes to the entry capacity regime are taken into account (eg adjustment of baselines, capacity Transfer and Trades, reduction in capacity withheld from the QSEC auctions, etc). The situation is further complicated at St Fergus given National Grid's recent proposal to remove part of the St Fergus feeder pipelines from natural gas service in 2013 to facilitate CO2 transportation.

In light of the level of industry concern on the potential consequences of entry capacity substitution, we consider it imperative that Ofgem undertake a comprehensive Impact Assessment covering all aspects of the entry capacity regime and any interaction with current carbon capture and storage proposals.

We hope that you will find these comments useful.

Yours sincerely



Geoff Freter
Commercial Manager

¹ Oil and Gas UK is the representative body for the offshore oil and gas exploration and production industry in the United Kingdom.

² Source: DECC Oil and Gas website https://www.og.berr.gov.uk/UKpromote/wos_task.htm