BG GROUP

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Dear Andrew,

Entry Capacity Substitution Methodology Consultation

We welcome the opportunity to respond to the consultation on Entry Capacity Substitution Methodology Statement. However we consider it regrettable that the industry seem to being forced down the route of a "retainer", and that other alternatives have been precluded at the 11th hour. For the reasons set out below, BG Gas Services does not support this methodology statement.

As a participant within Oil & Gas UK we are concerned that the recent correspondence between Malcolm Webb and Alistair Buchanan has not resolved our own, and seemingly other producers significant concerns on substitution.

Embarking on the "retainer" route is likely to result in a loss of overall system flexibility and a consequential adverse impact on security of supply. Furthermore, we remain to be convinced of the perceived consumer benefits from this move and would highlight the adverse impact of capacity squeezes (eg St Fergus July 2001; Easington 2007/8 and 2008/9) have had on the efficient operation of the market. The danger to the consumer remains one of not having enough spare capacity, particularly as future UKCS investment tends towards short/medium term incremental offshore developments.

The TBE process is highly respected across the industry as the benchmark for supply / demand and the information is corroborated by NGG with other industry experts, not just producers. The existing information has underpinned the current capacity Baselines and should not be ignored in reflecting future expected supplies. If it is, then potentially this trusted process will become less useful in future.

Whilst we understand that NGG will be revenue neutral under the Substitution methodology, we are concerned about the potential inefficiency of capacity being substituted away from a particular terminal where there are future demand signals. There is a very credible scenario where capacity could be substituted away one year, (in the absence sufficient "retainer" bids), only for a couple of years later, there to be incremental demand signals at the donor terminal. This could require further investment, potentially at higher cost, than if the investment had occurred where the original demand signal had come from.

Substitution of capacity is efficient where the future usage of capacity at a particular terminal is unlikely to be required, but is potentially inefficient where capacity is likely to be demanded at higher levels in a future period. Our understanding is that whilst Ofgem will have scrutiny on any substitution that NGG propose, there will be little or no discretion (assuming that NGG have followed the methodology), and in the absence of a User commitment, capacity destruction will occur. As the exchange rates moves away from 1:1, we would expect greater scrutiny to be applied on whether there is a real long term benefit from substitution occurring rather than denying the incremental investment to take place.

Given that all the options haven't been fully considered, we are reluctant to comment on the specifics of the methodology because we disagree with how it is being introduced. However, should we be forced down this route, we believe that Storage Operators and Interconnector Operators should be in a position to purchase Retainers if they wish (Para 30.) We agree with the change of name from "option" to "retainer" and we favour the Commitment Method B if this is the eventual route the industry have to follow. However, we are concerned that the "retainer" won't be actively used given the product "definition" (ie giving the purchaser of the retainer no rights other than to keep capacity at the ASEP for some future user, being refunded if such capacity is sold at the forthcoming QSEC auction). We believe that the retainer should provide some rights to first call on that capacity for a reasonable period of time, particularly if there is a sudden change in the final round of a QSEC auction, whereby the auction could be closed without the ability to respond to the new signal.

We would welcome the opportunity to discuss these comments further.

Yours sincerely

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