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16 March 2007

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Notice under Section 23(3) of the Gas Act 1986 – Revised Baselines for System Entry Capacity

Dear Bob

Thank you for the opportunity to comment on the licence amendment to Entry Capacity Baselines. Our response is not confidential and may therefore be placed in your library and on your website.

The transmission price control proposes on average a reduction by 13% of baseline capacities to be sold at existing system entry points, and a rebalancing away from some beach terminals and LNG facilities. In particular, the revised baselines are to be reduced below historical physical flows at Teesside and below expected flows at Easington and Bacton, given additional capacity requirements for recently completed import infrastructure. Capacity allocated to new onshore storage facilities is to increase, by a lesser amount giving an overall reduction of over 5%.

Without any other changes, the effect of this would be to reduce the risk to NGG of capacity buy-back, and increase risk to shippers at the affected terminals of being unable to land marginal gas on any day.

Under the Transmission Price Control^[1], Ofgem proposed to introduce a capacity transfer scheme. This would have the effect of mitigating some of the risks on affected shippers, by creating a mechanism whereby in certain circumstances some of the transferred-out capacity could be relocated back to the terminals whose available capacity had been reduced.

The justification for the revised baselines has still not been given. Early consultations on the Price Control suggested that significantly higher levels would be implemented, but these

^[1] Transmission Price Control Review: Final Proposals (4 December 2006) Ref 206/06, Paragraph 10.7

were changed at a late date without explanation. Despite invitations to comment, Ofgem has never satisfactorily explained the reasons for the late changes.

Similarly, NGG has not explained if the changes merely represent a change in the way that capacity is sold or reflects a change in the way that the system is managed, which means that the actual amount of capacity at certain points has genuinely been reduced.

The notice issued by Ofgem outlining the proposed licence modification^[2] separates the revised baselines from capacity transfer and other related issues, which BP believes is inappropriate as we understand they are integral to the settlement.

Early discussions on Network Code modifications proposing capacity transfer schemes have begun. However, they indicate NGG's preference to implement a mechanism which may be unworkable in practice, or of extremely limited benefit to shippers. Alternative modifications suggested by shippers indicate the complexity of introducing a scheme with adequate flexibility. There is a risk that an appropriate scheme will not be in place in time for winter 2007/8, with consequent risks to gas deliverability, increased price volatility, and increased risks to shippers who are active at the affected terminals.

An additional effect of the transfer of capacity away from beach entry points towards onshore storage also limits the amount of flexibility that can be provided from production (and LNG importation). If capacity transfers are not introduced, then gas will need to be landed in summer and stored in storage facilities in order to be delivered in winter, where it would be more efficient to transfer the entry capacity and use production flexibility to land the same gas in winter. This will increase the cost of the marginal therm.

As NGG benefits from the reductions in baselines, but loses from the introduction of flexible capacity rights, they could be placed in such a position that they are incentivised either to implement an unusable system or to delay implementation for as long as possible.

BP believes, therefore, that the licence amendments, which were clearly linked in the Transmission Price Control, should not be separated. Ofgem should defer a decision on implementing the licence amendment until a satisfactory capacity transfer mechanism is in place and that information has been published that allows shippers to estimate whether short term capacity will be available, or if gas will be stranded offshore and contracts for delivery at other points must be sought. If necessary, this would mean that the forthcoming capacity auctions should be carried out at the old baselines. This would maintain a strong incentive on NGG to carry out the necessary amendments to allow capacity transfers.

We trust that these comments are helpful and would be pleased to meet with you to discuss any aspect of them.

Yours sincerely,

Andrew Pearce
Regulatory Affairs

cc Sonia Brown, Ofgem

^[2] Notice under section 23(3) of the Gas Act 1986 (16 February 2007) Robert Hull