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Summary Report and Discussion Document on Entry Capacity Substitution

Dear Andrew

BP welcomes the opportunity to respond to this discussion paper. Our response is not confidential and may be placed on your website.

In principle BP supports the rationale of capacity substitution as a process that will help enable National Grid to run the NTS in an economic and efficient manner.

One of the aspects of capacity substitution is to prevent capacity at ASEPs that have a declining profile from being stranded. A concern with this is that it could see capacity moved away on a permanent basis thus perhaps preventing any future development projects from being landed at that ASEP without increased costs as shippers would have to signal their intent by bidding for incremental capacity.

BP is concerned that the introduction of substitution is being rushed through with the aim at present of being in place by June 2008. This would mean that the proposed process would be submitted to Ofgem by the 19th May. National Grid say "To minimise the potential for misunderstanding of the impact of substitution within the entire package of reform National Grid has held back from putting forward proposals until progress has been made on:

- the baseline re-consultation;
- an enduring solution for Transfer and Trade; and
- moving QSEC auction."

National Grid goes on to say that such a delay has condensed the available time for introducing substitution. This condensed time line would mean that the industry would only have until the beginning of April to come to an agreement on the process for substitution. It was shown with the Transfer and Trades process that rushing through a solution leads to an inefficient outcome. BP would urge that the introduction of substitution is delayed so that all interested parties can work together to find an acceptable and workable solution.

BP trusts that the above comments and the specific responses to the questions are of assistance to National Grid. Please do not hesitate to contact me on the number above if you wish to discuss any points raised in this letter.

Yours sincerely

Andrew Pearce
Regulatory Affairs

Answers to specific Questions

A. Capacity Available for Substitution.

What proportion of baseline capacity should be withheld from QSEC auctions (and substitution) for use in later auctions (the current Licence requirement is 10%)?

The amount of capacity held back in the QSEC auctions should be increased to 20%, the level that it was in the last Price Control. This would give some level of comfort to shippers that some short term capacity would be available in the AMSEC auction. Forcing shippers to purchase their entire capacity requirement in the QSEC auction is an uneconomic option as shippers can not predict accurately their production for the full QSEC period. Holding 20% back would also give assurance to developers of marginal fields that capacity would be available in the short term. Any uncertainty in the availability of capacity is bound to increase prices at the effected ASEP which will eventually be passed on the consumers.

Forecast Flows

Should National Grid exclude from substitutions capacity up to the level of forecast (as specified in the TYS) flows?

Forecast flow should be taken into account and held back from substitution. Shippers provide National Grid with forecast flow data in the Transporting Britain's Energy (TBE) process. National Grid say that they find the TBE process very helpful in network planning, to then ignore this would seem to make the whole process redundant.

Would this have an adverse impact on the quality of data provided in the Transporting Britain's Energy process which feeds into the TYS?

BP does not see why this would be the case. The TBE process is for the benefit of all parties.

Single Quarter Problem

Where capacity is currently booked at an ASEP for a single quarter in the future should this prevent capacity at that ASEP, to the level booked, being available for substitution in the period prior to that booking?

No, capacity should be available prior to that booking. The capacity should be returned for the booked period. Having said that this is a complex area and more debate should be given to the issue.

*If yes,
what about two quarters?*

As stated above this is a complex area and more debate should be given to this issue.

Should rules be introduced to prevent short-term, distant, bookings in future QSEC auctions?

As stated above this area needs to be looked at in more detail.

Should the substitution of capacity be time limited, i.e. substituted capacity reverts back to the original ASEP after a set period?

As Above

Should a mechanism be established to allow Users to surrender capacity, i.e. similar to that proposed for Transfer and Trades but for a distant time frame?

To allow shippers to surrender unwanted capacity to be used at that ASEP or substituted away seems to be a sensible option. This would prevent capacity becoming stranded at an ASEP. How surrender prices are set should be looked at in more detail.

B. Lower NPV Test

Considering the complexity of potential solutions, should different User commitment tests be applied for incremental capacity satisfied from substitution and from investment? If yes, how should a dual-test be implemented?

BP agrees with National Grid the same test should apply regardless of whether incremental capacity is achieved through investment or substitution. Although National Grid would not have to make any investment to provide substituted incremental capacity, shippers should still be required to show the same commitment to gaining that additional capacity. As National Grid state this capacity has the same value to the user regardless of how the request is satisfied.

Combined Substitution / Investment

In the event that incremental capacity is able to be released as a result of a combination of substitution and investment what test should be applied to trigger capacity release?

As stated above BP does not see the benefit of a lower NPV test for substitution.

Competing Bids for Substitutable Capacity

Where capacity available for substitution is limited and a lower NPV test applies, how should such capacity be used?

See above.

Where there are two or more incremental capacity requests that only satisfy the lower (if any) substitution test what rules should apply to prioritise requests? Should this be based on the relative NPV of the relevant bids? Are there any alternative measures that could be used?

As above.

Should capacity be substituted to support incremental capacity requests satisfying the investment test only after consideration of those requests that only satisfy the lower (if any) substitution test? Or vice versa? Or should the same rules applying above apply to all requests?

As above.

C. Exchange Rate Cap.

To avoid excessive capacity destruction should capacity substitutions be prohibited if the exchange rate exceeds a specified value?

BP agrees that there should be a cap on exchange rates. The situation of having an exchange rate of 19.5:1 as happened in the Transfers and Trade process in October 2007 demonstrates the effect of capacity destruction.

If yes, what should the cap on exchange rates be?

An exchange rate cap would seem appropriate although BP feel that this needs be looked at in more detail during any further industry consultation. To agree any cap the industry needs to have more clarity and comfort on how the exchange rates are set.

D. Availability of Capacity for Substitution

Assuming that substitution will be triggered by User bids submitted in the QSEC auctions for which capacity can be requested from 18 months ahead (e.g. April 2009 QSEC for October 2010 release) but substitution is intended to minimise investment (42 month lead time – October 2012 release) should National Grid substitute capacity to release incremental capacity ahead of 42 months?

Although there is an argument for a shorter lead time to deliver substituted capacity, thought should be given to the consequence this could have at the donor ASEP. Users may not have been able to secure firm capacity rights for the earlier substitution period forcing them to rely on interruptible capacity.

If yes, should any limit be placed on the timing of such release, e.g. 18 months, 30 months?

If shippers have the ability to purchase capacity if needed before the substitution via say an AMSEC auction then substituting capacity from two years out would seem sensible.

If yes, should any measures be taken to protect (some/any) capacity at donor ASEPs?

As stated above if shippers have the ability to purchase capacity this should not be necessary

Should substitution be limited to single donor ASEP or should combinations (substituted at different times) be allowed? All but the last would be time limited substitutions, e.g. Donor ASEP A used from year 2 to 4 but not available after year 4, donor ASEP B used from year 5.

In principle you could say that it should be allowed as happened in the Transfer and Trade process in October 2007, but this is a complex area and more analysis and debate should be given to it.

E. Other Issues

New Entry Points

Do respondents consider that undertaking separate QSEC auctions for new ASEPs is unduly preferential? Are there any discrimination issues?

No. If National Grid hold an additional QSEC auction for a new entry point shippers should be allowed to bid for capacity at all ASEPs, this would elevate any discrimination issues.

Bearing in mind that these auctions could trigger the release of significant quantities of incremental capacity at new ASEPs, should substitution be excluded from these auctions?

This should not be a problem if shippers can bid for capacity at all ASEPs.