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TPCR - Third Consultation

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Thankyou for the opportunity to comment on this consultation which ExxonMobil International Limited is responding to on behalf of its gas shipping entity ExxonMobil Gas Marketing Europe Limited.

Our response is limited to questions raised in Chapter 4 covering gas entry.

*4.1 Do you agree with our plans to change the nature of NGG NTS's licence obligations to release entry capacity? What particular measures are needed to ensure that the regime is transparent, and to insure against capacity being held back unnecessarily?*

We have already lent our support to Ofgem exploring possible refinements to the basis on which baseline capacity at entry is defined, in order to provide additional flexibility to move network capacity between entry points and to help identify long term stranded capacity.

However the fundamental nature of the reforms that Ofgem is proposing involves a disconcerting transfer of responsibility for the determination of capacity release to the Transmission Owner with governance provided by the industry. We consider that these proposals introduce a very significant level of uncertainty regarding future access to market that has not existed for the past five years. We cannot see how reforms of this nature will serve the interests of GB consumers.

Changing NGG's licence obligations such that it is required to e.g. "maximize release of capacity" will not by itself neutralize the significant information advantage that the Transmission Owner retains and which could be misused to restrict capacity release at individual entry points. We doubt that this issue could be overcome even by providing industry with a detailed methodology approval from Ofgem, access to a sophisticated network model and an enhanced governance regime.

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We further question quite simply whether industry as a whole can be effective in policing a capacity release regime given its inferior access to information and the fact that the numbers involved in industry will inevitably delay agreement on interpretation of information (given the engineering complexity inherent in an integrated gas network such as the NTS). Costs as well as feasibility are a concern as the level of information required to properly support capacity release decisions would at least amount to that provided through a full Graphical Falcon engineering model. Furthermore the operation and interpretation of such network models are complex, requiring dedicated engineering expertise which would represent a significant cost burden for shippers needing or wishing to use them. Ofgem would therefore have to resort to simplified, user friendly models, compromising accuracy and transparency and leading to capacity release quantities that would be different to those calculated by the Transmission Owner, who would be optimizing results on the more sophisticated basis. All this then begs the question as to whether industry is capable of policing capacity release at all, let alone as efficiently as Ofgem.

A frightening end result could be that of multiple protracted disputes and untimely decisions, with Ofgem frequently called upon to intervene to resolve. Such a situation would be made worse were Ofgem to find itself with inadequate powers to respond effectively and on a timely basis. Additional cost consequences may arise if significant redesign of current auction arrangements were required.

In order to maintain the confidence of shippers and investors, and in the interests of a balanced and informed debate going forward, we would encourage Ofgem to develop (at least in parallel) of an alternative scheme that does not introduce such levels of uncertainty regarding future market access. Such an alternative scheme might be one that maintains the current defined nodal capacity release structure with rational variations designed to address the stated concerns of inflexibility across entry points. One way of introducing flexibility might be to redefine unsold nodal baseline capacity between baseline, zonal and network global commodities.

*4.2 Do you agree with our plans to refine how the revenue drivers work in cases where NGG NTS provides extra NTS entry capacity, as requested by network users?*

We agree with Ofgem's statement that current licence calculations supporting revenue allowances for incremental capacity release are complex and that some simplification is clearly desirable.

Ofgem proposes to retain entry point specific revenue drivers, and for each existing entry point and known new entry points set "trigger levels" such that where quantities of long run entry capacity were allocated above this level, the revenue driver would be activated and an incremental revenue allowance established. The revenue allowance would be fixed for the period of the price control based on the deemed investment cost and assuming a standard rate of return (to be determined).

On the face of it therefore, this part of Ofgem's plan is similar to arrangements existing today insofar as (i) it is entry point specific and (ii) User commitment is required above defined trigger levels. Hence we support the retention of these two broad features.

As far as the deemed unit costs of incremental investment are concerned, Ofgem explains in Appendix 10 the modeling that it has asked the Transmission Owner to perform but the results of only one case, namely the “Transit UK + least helpful substitution” case is given and then only for one year 2008/09. Significantly more reference points are required to have an informed debate before setting individual revenue allowances and capacity trigger levels.

We would support Ofgem’s plans to secure and publish results for all modeling cases, including those derived for the “most helpful substitution” and “pro rata substitution” methods. In this area we have some questions that we hope Ofgem will be able to address quickly:

1. To be able to calculate and agree trigger levels of capacity and unit revenue allowances, Ofgem would, it seems to us, first have to be satisfied as to the existing level of transmission capacity. Without agreement on the capacity of the base network there would be risk that the regulations would reward more than one revenue allowance for the same quantity of capacity.

Is Ofgem going to share these base capacity assumptions with industry?

2. We cannot see how the proposals provide an incentive on NGG to build new capacity when they are based on a standard rate of return. That is, unless it is Ofgem’s intention that the incremental deemed cost of capacity on which the “standard return” is based is set at the so called upper cost bound level (the Transit + Least Helpful Substitution case).

Is it Ofgem’s intention to use the upper cost result as a proxy for a higher rate of return ?

If that is the case it is easier to see why this approach is a simplification and also why it might represent an incentive to NGG, but the further question then is what is the magnitude of the incentive that Ofgem is making available to NGG ?

Can Ofgem prepare data to help characterize the level of the incentive that this approach might represent ?

*4.3 Do you agree that changes are needed to the arrangements for buying back capacity rights, in particular to ensure a different sharing of risk between shippers, NGG NTS and consumers in respect of capacity which is dependent on large investment projects ?*

We have already indicated in our response to the second consultation our support for Ofgem to apply a different treatment on capacity buyback caused by investment delay.

Our views on the availability of buy back compensation in the event of delays to currently committed projects have already been provided in our response to the second consultation.

For future projects, the main challenge is one of providing an overall structure that provides a clear and adequate incentive for the Transmission Owner to provide capacity on time. As long as NGG has access to an incremental return on new investment and carries a commercially significant level of exposure to buy back costs, risks of delay are significantly reduced.

Whilst we understand Ofgem's inclination to apply "caps" to compensation available through the buyback mechanism, we question whether a prescriptive approach is, or is always, in the interests of investors or GB consumers. It may be that one investor shipper could agree with a cap where it is already comfortable that the inherent risks of the associated pipeline project are small, where it is comfortable that NGG performance is adequately underpinned in the incentive structure, and where consequences of failure may be limited. There may be other investments, equally or more significant to GB, where associated pipeline risks are much higher and the consequences of delay much greater. A one size fits all solution seems less than sensible if it is accepted that each project will be different in its overall risk profile. We question whether shippers, even with additional flexibility to negotiate some terms with the transmission owners, could contribute effectively to managing the risk profile.

Hence it remains our view that buyback costs for any future project should in principle be allowed at the level of economic costs and that only if or when investment delays actually occur and only if significant costs arise under buyback might Ofgem take its opportunity to intervene and review. It would be useful for Ofgem to determine in advance the basis on which such reviews might proceed.

We trust that you will take into account these views and will call us should you need any clarification.

Yours sincerely,

A handwritten signature in blue ink, appearing to read 'I. Trickle', with a stylized flourish underneath.

Ian Trickle