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Dear David

BG Group Response to Consultation on Proposed Incentive Arrangements for the Provision of NTS Entry Capacity at Milford Haven.

BG Group ("BG") welcomes the opportunity to respond to the above consultation. As a North Sea producer, supplying 6% of UK demand in 2005, and active participant in the wholesale market BG holds capacity at a number of entry points onto the NTS including Bacton, Easington, Teesside and St Fergus. BG holds a UK shipper's licence under the name of BG Energy Services Ltd.

Background

BG has 50% of the long term capacity rights in the Dragon LNG terminal, currently under construction at Milford Haven. BG is also a 50% shareholder in Dragon LNG. In order to ensure that there would be sufficient NTS entry capacity to service an LNG terminal Dragon signed Preliminary Works Agreements (PWA) in 2003 and early 2004 with National Grid. These agreements included the payment of several million pounds to National Grid to fund work required to enable investment in a new NTS connection. The PWA payments were non-refundable in the event that shippers did not book capacity in the 2004 entry capacity auctions. BG and other shippers participated in the long term entry capacity auctions at Milford Haven in 2004; the results of these auctions were sufficient to trigger the release by National Grid of obligated incremental entry capacity at Milford Haven.

From 2002 onwards Dragon and its partners had close contact with National Grid to ensure that National Grid was fully informed of Dragon's intentions to construct an LNG terminal and the resultant need for NTS capacity. It is important to recognise that Dragon and its shippers went to considerable lengths to ensure that National Grid would be able to deliver new NTS capacity on time. This included the acceptance of financial risk; at the time the PWAs were signed it was not certain that the project would receive an acceptable exemption from Third Party Access under Article 22 of the Second Gas Directive. Had such an exemption not been forthcoming, the project would not have been able to proceed and the money paid to National Grid under the PWA would have been lost.

Response to the Consultation.

In light of the above BG has the following comments on the consultation.

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Should new incentive arrangements be developed in relation to the delivery of gas transportation capacity for Milford Haven?

BG agrees that new incentive arrangements are required at Milford Haven as a result of the potential size of the buybacks, and the importance of the new capacity to the UK. It would be wrong that the existing buyback regime should be potentially "swamped" by the extent of buybacks at Milford Haven, hence the need for incentives specific to Milford Haven. Additionally it would be the wrong outcome if the current buyback regime caps were reached so that there was insufficient incentive on National Grid to complete the pipeline connection and NTS reinforcement related to Milford Haven.

Are the principles identified in paragraph 4.3 an appropriate basis for new incentive arrangements?

BG agrees with the principle that consumers should be protected from meeting costs that have arisen because of inefficiency. BG would add that shippers should not be exposed to costs incurred due to poor performance by National Grid. In particular the temptation to target costs back on Milford Haven shippers should be avoided since the Milford Haven shippers have gone beyond the requirements of the regime to ensure National Grid had the signals to invest. Targeting costs on Milford Haven shippers would be perverse as it would mean they would end up paying for their own buyback costs, costs which would have been the result of National Grid's failure to provide capacity.

BG agrees with the principle that any new incentive arrangements should encourage National Grid to deliver NTS capacity in a timely manner. The more National Grid is shielded from buyback costs, the less the incentive on National Grid to perform. Whilst we appreciate that National Grid is making every effort to ensure the pipeline is completed on time, we believe that it is only fair that National Grid should pay a reasonable proportion of the costs in the event that the pipeline is late.

Whilst BG understands the need to ensure that National Grid is financially viable, BG does not agree that a regulated regime should mean that National Grid faces no risks. National Grid's costs of capital reflects the fact that it does not face market risk and has much greater certainty as to its revenues than a company operating in a competitive environment. However a regulated company should still face operating risk relating to its business, otherwise its shareholders benefit at the expense of its customers. National Grid is already protected from "undue" risk; further protection from undue risk should result in a lower cost of capital.

BG agrees that where National Grid is unable to meet its obligations to provide capacity that appropriate compensation should be greater than a simple refund of transportation charges. This reflects the fact that shippers face risks and costs which exceed transportation costs as a result of their inability to receive LNG and deliver it to the UK market.

Should National Grid Gas NTS' exposure to buyback costs be deferred if there are undue delays due to consents for the construction of the reinforcement pipelines, adverse weather conditions or other exceptional factors?

As written the question is too loosely drafted. Building and operating pipelines is the core of National Grid's business. Therefore the planning process and the UK weather should form a legitimate part of the operational risk that National Grid faces. National Grid has a degree of control over the planning process as it is able to determine the quality and timing of its planning applications., It is also reasonable to expect that National Grid has sufficient experience of working in the UK to factor weather conditions into its project planning and management.

BG accepts that there may be very extreme circumstances which prevent National Grid from completing the pipeline on time and which are outside National Grid's control, for example movement restrictions due to foot and mouth. However if National Grid's exposure to buyback costs is to be deferred, the circumstances would need to be very carefully defined. Otherwise the whole rationale of the buyback incentive regime risks being undermined.

Should this deferral "skip" the period November-February during which construction is not practical?

BG does not agree with this. National Grid may still be able to carry out work during this period. Skipping the period November to February as part of any deferral merely weakens the incentives on National Grid further.

What are the advantages and disadvantages of the new incentive arrangements described in this chapter?

BG considers Option A as being the best way to improve incentives on National Grid from the Options presented. BG would argue that National Grid should bear a greater proportion of any buyback costs (potentially more than the 35% sharing factor) for the reasons stated above (the PWAs signed by shippers, the risk involved in pipeline construction is part of National Grid's core business). Option A provides additional incentive on National Grid to complete the pipeline as soon as possible, and ensures that National Grid will pick up at least some of the buyback costs. It minimises the costs borne by the community should National Grid complete the work mid way through a quarter. The other options would see more costs borne by the Shipping community. BG believe that the proposal should relate to the first year of the 2007-2012 Price Control. BG would expect that in the event that there is further slippage beyond April 2008 the target would be reset to incentivise National Grid.

Are there further steps which should be taken to encourage National Grid Gas NTS and the relevant shippers to enter into arrangements that would minimise the economic costs of any delay in the provision of transmission capacity at Milford Haven?

As noted above BG and Dragon have already taken significant steps to help National Grid deliver capacity on time. BG has also had several discussions with National Grid in recent months to help resolve the issue, and is continuing to do so. Other than the proposals to enhance the incentives on National Grid described above, BG does not believe that further steps at an industry level need to be taken.

I hope the above comments are useful. If you have any queries please do not hesitate to contact me on 0118 929 3442.

Yours sincerely

Alex Barnes
Commercial and Regulation Manager