23rd October 2006

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Dear Bob

BG Gas Services Limited Response to Transmission Price Control review 2007 - 2012. Updated Proposals.

BG Gas Services Limited ("BG") welcomes the opportunity to respond to Ofgem's Updated Proposals on the Transmission Price Control. BG is active in the UK market as a gas shipper, marketing and trading gas on behalf of BG Group's UKCS production activities. In addition BG Group has both equity interests and capacity rights in the Dragon LNG terminal currently under construction at Milford Haven in south Wales. Our comments below therefore focus on the Price Control for National Grid Gas' transmission activities, with emphasis on the gas entry incentives.

Chapter 10. Adjustment mechanisms and incentives: gas.

Question 10.1: Do you agree with Ofgem's proposals for the treatment of entry and off-take capacity release obligations, and capacity substitution?

BG approves of Ofgem's use of baselines for entry capacity and its commitment that entry capacity baselines will not be less than the obligated capacity already sold for an entry point. We therefore presume that the baseline for the Milford Haven terminal will be 950 GWhd, not 877 GWhd as in Ofgem's Initial Proposals as outlined in Table A9.1.

BG also notes Ofgem's proposal to reduce the amount of capacity held back in the long term auctions to 10%, and the intention to withdraw this requirement in the next Price Control. It would be helpful if, during the next Price Control consultation, Ofgem made its intentions regarding the 10% rule clear as early as possible, and in particular in advance of that year's long term entry capacity auctions. Otherwise shippers may not be able to give clear investment signals to NGG as to their future capacity requirements.

BG supports Ofgem's proposals on substitution of capacity obligations and associated methodologies. Much will clearly depend on the methodology that NGG will develop for baseline revisions and the calculation of the exchange rate for transfer of capacity between entry points. BG would like to highlight the issues it raised in its previous response, namely the lead time for the transfer of capacity between terminals, and the quantity of capacity that can be transferred from an under-booked terminal to one where demand exceeds the baseline as

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these could impact incremental gas field developments. These developments can have short lead times and short life-spans. However they can represent a valuable contribution to UK security of gas supply at a time when the UKCS overall is in decline. Consideration of reform of the entry capacity regime should include whether there is a risk that reform may limit companies' ability to bring this gas into the NTS.

It is not clear that it would be helpful for a shippers to participate in an auction at one entry point simply to buy capacity in order to transfer it to another entry. This could have the impact of confusing signals as to the real amount of capacity required at each individual entry point. Logically the price for capacity at an individual entry point should be cheaper than buying capacity at another entry point and then exchanging it. Therefore it is not clear in what circumstances a shipper would try to buy capacity in the auctions at another entry point in order to exchange it, rather than try and buy its required capacity at its first choice entry point.

Question 10.3 what are your views of Ofgem's proposals on buyback incentives, in particular in relation to lead times and caps on exposure?

BG is not clear why the default lead time has been extended to 42 months for entry capacity as there is no supporting evidence for this proposal. BG accepts that provision of entry capacity may be time consuming and that planning consent may take time. However as BG has also pointed out in the past, managing and delivery infrastructure projects is part of NGG's core business. It is important that NGG is set sufficiently demanding targets with regards to its service levels as it faces no competition, unlike contractors in competitive industries. Ofgem's Initial Proposals, that NGG can vary lead times as a result of bilateral agreements with shippers, plus the ability to apply to Ofgem on a case by case basis, should give NGG sufficient flexibility to manage its obligations.

BG does not agree with the proposal that NGG should have a limited number of permits enabling it to extend lead times, rather than apply to Ofgem on a case by case basis. Other than allowing NGG to avoid justifying to Ofgem why it needs an extension, it is not clear what advantage this proposal has. In a period when NGG has an above average number of difficult projects, NGG would not have sufficient permits. In a period when it had an above average number of easy projects, NGG would have an incentive to complete its projects more slowly as otherwise it would lose the benefit of the permits it had been allocated. In short the proposal appears to be an artificial construct and no substitute for regulatory oversight, on a case by case basis, by Ofgem of NGG's project management and delivery.

BG notes that the Updated Proposals now refer to a "price cap" rather than an "administered price" for incremental capacity which shippers sell back to NGG. The document does not explain how this differs from the Initial Proposals, but it implies that NGG may be able to buy back capacity at a lower price than the cap, although the price at which shippers sell will be capped at some maximum. This clearly has implications for the risk borne by NGG and shippers respectively, and implies asymmetric risk for shippers. Since, under this proposal, NGG has its liabilities capped whilst shippers ability to recover losses is also limited, it would be logical if NGG bore a greater share of buyback costs were this proposal to be implemented.

BG's supports in principle the idea of an administered price, set in advance, for incremental capacity which shippers sell back to NGG, rather than a price cap. However as we stated in our response to the Initial Proposals BG believes that the price should reflect the economic losses borne by shippers as a result of NGG's failure to deliver capacity. BG did not support Ofgem's proposal for calculation of the buyback price in the Initial Proposal and suggested alternatives. Please see our response to the Initial Proposals for further details.

On exit capacity BG notes that the proposals in paragraphs 10.13 and 10.14 imply giving current interruptible customers firm rights, and then giving NGG an allowance to buy back these firm rights to manage potential interruptions. It is worth noting that NGG and Ofgem have expressed concerns in the past concerning the market power of shippers at entry points with regard to buybacks where there are a limited number of shippers. Ofgem's proposals seem to be creating the same type of problem at exit, given that there will be limited interruptible customers at an exit point.

Question 10.5 Do you agree with our view that an Innovation Funding Incentive is appropriate?

BG does not agree that an Innovation Funding Incentive is appropriate. Whilst BG is supportive of efforts by NGG NTS to innovate, it is not clear from the document why a separate incentive is required for this activity. NGG NTS should have sufficient incentive under RPI-X regulation to innovate and thereby increase its profitability. It is not clear from the document how the incentive will be policed to see that consumers or shippers receive value for money from this incentive. Please see also our comments in our response to the Initial Proposals.

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,

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