



2 March 2007

Clare Sibly
Project Leader – Gas Quality
Office of Gas and Electricity Markets
9 Millbank
London
SW1P 3GE

Dear Clare

**Gas Quality Scenario Development and Economic Regulation Workstreams –
Conclusions.**

Thank you for the opportunity to comment on the above report. BG Gas Services Limited (“BG”) holds a shipper licence under the Gas Act. BG Gas Services is part of BG Group and sells gas on behalf of affiliate companies in the UK wholesale market. BG Group also has equity and capacity rights in the Bacton – Zeebrugge Interconnector, and in the Dragon LNG terminal currently under construction.

BG appreciates the time and effort Ofgem has spent in leading discussions on the gas quality issue. From our participation in the workstreams led by Ofgem it is very clear that there are no easy solutions to the problem of how to ensure there are sufficient gas quality treatment facilities in place in the UK in a timely manner. A key learning from the workstreams is that there is a high degree of uncertainty as to how much treatment capacity the UK will need and when. This represents a major hurdle to investment in a purely commercial framework. However it is also clear that the costs to UK consumers could be high if the UK is unable to import sufficient gas due to lack of treatment capacity. In this scenario one would expect prices to rise until demand is “choked off”. As we have seen in the past such price spikes can be very high indeed.

Whilst we appreciate Ofgem’s arguments against a pure regulated approach where investment is simply included in National Grid’s Regulated Asset Base, BG does not support the Hybrid approach outlined in the document. As currently proposed we believe the Hybrid approach is no different from the unregulated approach in practice, as National Grid must have all proposed investment underwritten or face bearing the costs of any unused capacity itself. The situation today, which is akin to the unregulated approach in the document, is very similar since no company will build treatment capacity unless it believes it will earn a reasonable return, which in turn requires a high level of user commitments. Indeed BG is sure that National Grid would invest today if it was reasonably certain that it would earn a decent return.

However, for the reasons outlined above and in the document, there is such a high degree of uncertainty that companies are unlikely to give sufficient commitments to invest until it is much clearer that there is a continuous need for treatment facilities. Until this happens the UK will run

BG Gas Services Limited
Thames Valley Park
Reading Berkshire
RG6 1PT UK
www.bg-group.com
Tel 0118 929 3442
Fax 0118 929 3273
alex.barnes@bg-group.com

the risk of price spikes. For this reason BG does not believe that the Hybrid Proposal answers the question of how to ensure there is sufficient capacity in place in a timely manner. BG would prefer that there were further discussion of a “true hybrid” whereby NG builds in response to some level of long term booking from the market, but does not require 100% user commitments prior to investment. The costs of capacity that was built but not paid for could be recovered via the RAB via a specific charge on consumers. Companies could book on a shorter term basis (as NG would be required to sell unsold capacity up to the gas day) but would have to pay a fair share of total costs as a minimum, and more if demand for capacity was high on a day. In other words they would not be able to buy capacity cheaply on the day as is the case in entry capacity.

It remains to be seen if such an approach could be made to work. For example, we recognise that there may be “free rider” difficulties due to the commingling of gas streams. Also much depends on the gas quality specification at the Zeebrugge Hub and, in the future the Zeebrugge Platform which will affect the quality (and in turn this effects the quantity) of gas available for import to the UK and the need for treatment. However under this approach, although consumers would face the costs of unused capacity in the early days, they would benefit from having capacity actually in place which would limit the potential for price spikes. This contrasts with the Hybrid approach in the document where no capacity at all will be built without 100% User commitments. Ofgem involvement in developing such an approach would be essential because of the regulatory aspects, and continued facilitation by Ofgem would be helpful. Indeed it is clear that without a lead from Ofgem it is unlikely that the discussion of this topic would have progressed this far.

Should you have any queries please do not hesitate to contact me on 0118 929 3442 or at alex.barnes@bg-group.com.

Yours sincerely,

Alex Barnes
Commercial and Regulation Manager
Europe Downstream