



12 January 2007

Julian Majdanski
Joint Office of Gas Transporters
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Dear Julian

BG Gas Services Limited Response to Code Modification Proposal 129 "Delay to the 2007 Amsec Auction.

As we stated in our response to Modification Proposal 128 BG Gas Services Limited remains concerned at the impact of the proposed changes to baselines at Teesside. Whilst we understand the rationale behind Modification Proposal 129, and believe it to be an improvement on Modification Proposal 128, it still does not address the root cause of the problem. This is the significant reduction in baselines from 761 GWhd to 361 GWhd.

In Ofgem's Updated Proposals the baseline capacity proposed for Teesside was 684 GWhd for 2008/9 which appeared a reasonable level. According to Ofgem the figures for 2006/7 would be calculated by subtracting from the 2008/9 figures any incremental capacity. However the difference between the figure of 361 GWhd in the Modification Proposal and the Updated proposals figure seems very large. BG would welcome clarification as to how the 361 GWhd figure was calculated. BG also notes that, according to our analysis, flows at Teesside have exceeded the propose new baseline on a number of occasions. It is perverse that the new baselines will be below the level of capacity bought in previous auctions whether on a long or short term basis, and below the level of gas flows in the past. This issue is of additional concern given the additional volumes that may be expected to flow from the new Excelerate LNG project.

A key problem here is that the significant change in the baselines has not enabled shippers to signal the need for new baseline capacity at Teesside in sufficient time to enable NGG to make the relevant investments. Prior to the publication of Ofgem's Final Proposals which contained the new baseline figure of 361 GWhd, shippers would have had the reasonable expectation that baselines would be the same or similar to the current level of 761 GWhd. Indeed Ofgem's Updated Proposals contained a figure of 684 GWhd. Shippers did not have the opportunity to comment on the proposed Baseline of 361 GWhd as it was in Ofgem's Final Proposals.

Shippers would have had to bid in LTSEC auctions in September 2004 in order to trigger investment new capacity above baseline by 2007/8 because of the 3 year lead time on new capacity. However shippers did not know in 2004 that the baseline would be reduced to 361 GWhd and therefore could not be expected to bid for new capacity in excess of this level. Therefore, if the new baselines are based on physical capacity, the timing of the change in

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baselines has denied shippers the opportunity to signal the demand for new capacity. If the new baselines are below physical capacity, this creates an artificial constraint. This would appear to be the case because we have seen historic flows in excess of the new baselines.

Either way, there has been a significant regulatory failure. It is essential that there is a degree of stability in the entry capacity regime to enable shippers to make appropriate investment decisions. We would urge Ofgem and NGG to revisit the proposed baseline for Teesside. We note that the Theddlethorpe Baseline, although reduced, remains in excess of flows.

This issue illustrates the problem of having baselines contained in a 5 year Price Control, whilst the auctions of capacity go across Price Control Period. This is unavoidable because of the need for regular Price Controls; however it illustrates the need for ensuring a reasonable degree of stability across price controls. This stability has not been apparent in this case.

Yours sincerely,

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