**From:** "Dalton, Mark" <mark.dalton@bg-group.com>
**Subject:** **Mod 349 - response from BG Group**
**Date:** 9 December 2010 16:57:40 GMT
**To:** "Joint Office" <enquiries@gasgovernance.co.uk>

Dear Tim,

We are responding in support of the Mod proposal 349 that was sent out for consultation on 18th November 2010.

In developing this Modification, we considered a number of different ways of approaching the issue, taking note of the reasons why Ofgem rejected Mod 262. This included mirroring the FM terms on exit (ie they apply for just 7 days and thereafter it is NGG's liability); amending the Buyback rules so that NGG are forced to purchase the capacity back in the event of FM and other elements that would have potentially required licence amendments. However on balance we felt that the proposed Modification approach best balances the relevant objectives with aiming to maximise flows of gas, minimising regulatory or administrative burden and automating the process.

We trust that all the industry can agree that it is wrong that a shipper should pay for capacity that doesn't exist by reason of FM. The current rules, and the knowledge of a tangible and significant FM case act as a significant risk on shippers to invest in incremental entry capacity, because they might have to pay for something that NGG fail to deliver. Without resolving this, the UK will continue to disadvantage itself in terms of attracting incremental capacity investments, as the financial exposure to the capacity buyer from NGG's failure to make capacity available can be very significant.

This Modification does not restrict a shipper's ability to take legal action against NGG for claiming FM, but it does protect the shipper from the financial exposure of the entry capacity that NGG have failed to make available. It is not aimed at providing "compensation", it is simply ensuring that the shipper ultimately is not paying for capacity that doesn't exist (the mechanism being that the shipper does pay for the capacity and this sum of money is then rebated back the following month as part of the "Option premium"). Therefore this Mod is not discriminatory between different terminals. Where a terminal has a very low capacity price paid (paid, not the reserve price), then that amount is refunded by this Mod; where a terminal has a higher capacity price paid, then that amount would also be refunded in the very rare event of FM being declared. It is not aimed at providing compensation to shippers – that is for a legal case to recover additional costs – this Mod is simply about not having to pay for capacity that isn't available due to NGG declaring FM.

The Modification is an improvement on Mod262 in the sense that NGG will now pay 50% of the exposure based upon their Buyback incentive. Under Mod262, 100% of the cost would have been borne by entry capacity holders, but now this is only 50%, with NGG paying the additional 50%. It was considered unrealistic for NGG to accept 100% of the cost of FM, so, like many other compromises within the UNC, the use of the Buyback Incentive was considered the most appropriate. We would not expect NGG to be approaching Ofgem for an increase in their incentive to cover off this additional cost they would be bearing. Furthermore, it is reasonable to apply the same incentive mechanism that would occur under any other buyback arrangement – ie that NGG pay 50% of the cost rather than where some shippers may argue that NGG should bear 100% of the cost until their Buyback incentive is used up. It is appropriate that if the Buyback incentive is used, the rationale of a 50:50 sharing arrangement is maintained rather than adjusting sharing factors under different circumstances.

This Modification is not retrospective although it would apply to capacity impacted by prior declaration of FM, from the date of the implementation onwards. This is entirely appropriate as a mechanism to resolve the principle that is being impacted….ie that one shouldn't pay for something that doesn't exist. The Modification prevents "gaming" of knowing that an FM event is in existence by limiting the action to capacity that existed prior to FM being declared. Therefore arguments aimed at limiting this application to future FM events reflect protectionist tendencies (ie not wanting to share a proportion of the costs) rather than following a consistent principle that .

The Modification is targeted at the Registered User because NGG are unable to cost-effectively adapt their systems effectively to make this apply to the capacity holders. Given that FM is a very rare event, this is an appropriate and practical compromise. The Modification has been framed as an Option rather than a mandatory buyback because it provides an incentive to maximise flows of gas at the ASEP between the capacity holders upto the limit of the constraint. If it was decided that a Buyback mechanism was more appropriate, then this would serve to restrict the overall flow of gas at an ASEP and would require additional capacity trading relationships between counterparties that might be unwilling to trade with each other.

In conclusion, this Modification improves the relevant objectives and provides a practical solution for the treatment of capacity costs in the event of NGG declaring FM. It is time critical given the continued failure at Milford Haven and represents the best way of ensuring a fair outcome to a significant, but absent subject to FM, piece of infrastructure.

We trust that the points made above are clear but please feel free to contact me on 07747 455 711 if you require further clarification.

Best regards,

Mark Dalton

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