

**Statoil (U.K.) Limited
Gas Division**

Statoil House
11a Regent Street
London SW1Y 4ST

Switchboard: 020 7410 6000
Central Fax: 020 7410 6100
Website: www.statoil.co.uk
Email: rob.cross@Statoil.com
Direct Line: 020 7410 6157
Direct Fax: 020 7410 6108

Nienke Hendriks
Senior Manager, Gas Transmission
Office of Gas and Electricity Markets
9 Millbank
London SW1P 3GE

30 June 2005

Dear Nienke,

Gas Transmission – new NTS entry points, reserve prices in auctions and unit cost allowances (UCAs)

Thank you for the opportunity to respond to the above consultation. Statoil (U.K.) Limited (STUK) is an active participant in the UK in trading, supply to major end users and marketing equity gas. As such we have been active participants in the auctions process on a regular basis. The entry capacity auction process was developed over considerable time and went through many manifestations before reaching the current arrangements. The original short term auctions, occurring every six months, created extreme prices and lead to cross subsidisation between entry and exit. The long term regime that developed out of this process was designed to give access to capacity on a long term basis with relatively stable prices. It was felt this was necessary to back up investment in gas fields and new import projects and to give the potential for expansion of terminals.

While it is unrealistic to expect any market regime to remain static for a long period of time STUK are concerned about the impact that some of the changes proposed by Ofgem may have in the UK. In establishing a long term regime Ofgem were seeking to stabilise the capacity market. However, proposing such significant changes part way through a formula period (when prices could be expected to remain relatively stable) may undermine market confidence in the long term product.

As a result STUK do not think there should be any significant changes to the current UCAs this year but that this consultation could be continued as part of the price control review. Below are some further comments on the specific proposals put forward.

The proposed model

Ofgem rightly highlight that the use of baseline capacity as the determining factor in the level of capacity that Transco must release means that a number of terminals have capacity available vastly in excess of the actual flows expected for those terminals.



If Transco model their network from a base which is not the SO baseline then this may disconnect with the auction process. If incremental costs are derived from a network 'smaller' than the baseline figures yet any demand for incremental capacity must be in excess of baseline at the auction, what affect will this have on Transco's incentive for investment and cost recovery? STUK would like further clarity from Ofgem of the effect this interaction would have.

The use of a Load absorption model will satisfy requirements where the incremental load signalled is relatively small. However, given the increase in supplies to the UK over the next 5 years it is likely that there will be a great deal of spare capacity in the UK. It is unlikely that demand will be able to absorb the increased supply other than through the interconnector (perhaps also BBL); this will also be subject to a maximum capacity for export to Europe.

It may therefore be unsuitable to always increase demand in all routes to absorb the increased flow at entry. Given that the UK will become increasingly dependent on imported gas it is increasingly likely the destination of this gas will be determined on a European and Global basis and not necessarily be brought to the UK.

Reinforcement

Projects to deliver increased capacity on the NTS not only benefit the specific projects for new gas supplies they also have additional benefits for the network as a whole. Two current investment projects (the Trans-Pennine pipeline and the connection to Milford Haven) will greatly stabilised the NTS and provide additional benefits to Transco and other Users. As such it does not always seem appropriate to target 100% of these costs to the parties creating the initial investment, particularly where security of supply is improved.

TO commodity charge

The introduction of baseline capacity and the removal of reserve prices in the withinday auctions have had a considerable effect on the ability of Transco to recover its allowed revenue at entry. The introduction of the TO commodity charge was brought about to address this issue but essentially cross subsidises under utilised terminals through higher costs of deliveries for those bring gas to the UK. As STUK have previously highlighted in correspondence with Ofgem it also allows new entry terminals to be built paying for only 50% of the costs, acknowledging that all entry flows will pay for the remainder in the future.

NPV Test

The advantages of the NPV test are that it enables Transco to deliver investment capacity where there is not a consistent period of demand over consecutive quarters. This would allow a seasonal bidder in an auction to still trigger incremental capacity release if the value of the bids reached a pre determined level. At present, where there are few bidders, there is an incentive to trigger the required total capacity level hitting as close as possible to the target cost figures of 50% of Transco's NPV knowing that after the purchase period they should be able to pick up capacity free on the day as there will be limited competition for capacity.

Proposed UCAs



The changes proposed by Ofgem significantly alter the UCAs and therefore reserve prices at all terminals. While this adjustment may reflect a change in the pattern of flows in the network based on new supplies in the future it should be assessed against the need to maintain a stable process for updating the UCAs and reviewing the whole process of long term auctions. With such a long term product it is important to limit the volatility and uncertainty of long term prices. It may therefore be better to adjust these prices as part of the price control review.

Policy issues

It would seem appropriate for Transco to continue to develop the UCAs for new Entry terminals. The use of an agreed process is useful for applicants but may need to be flexible to accommodate specific needs of projects.

An annual review of UCAs would not be suitable given the long term nature of the product and the need for some level of pricing stability highlighted above.

While STUK welcome a review of the auctions process and the way in which UCAs are set it seems appropriate to consider development over a longer timeframe consistent with those originally envisaged as part of the long term auctions process. STUK trust that our comments will be given due consideration and should you wish to discuss any aspect of this response further please contact me on the above number.

Yours sincerely

Robert Cross
Regulatory Affairs Manager

