bp

Fiona Lewis

European Regulatory Affairs
Gas Trading Europe and LNG

BP Gas Marketing ltd
20 Canada Square
Canary Wharf
London
E14 5NJ
United Kingdom

27th February 2007
Hannah Cook
9 Millbank
London
SW1P 3GE

Direct: +44 (0)20 7948 3881
Main: +44 (0)20 7948 5066
Mobile: +44 (0)7887 634528
Fax: +44(0)2079487844
Main: +44 (0)20 7948 5000
Fiona.Lewis@bp.com

Dear Hannah

Gas quality has been raised as a potential issue which might prevent the importation of gas from continental Europe under certain specific circumstances, and could therefore adversely affect trading between NBP and the Zeebrugge hub. Despite the good work at the Ofgem-led workshops, a number of uncertainties remain, which are likely to deter shippers from making long term commitments to underwrite investment to address this. In this light, the suggested 'hybrid' approach may not provide the insurance desired by Ofgem to prevent gas interruptions and price spikes caused by gas quality. BP considers that several areas are worthy of further investigation before a recommendation is made.

The term of the investment is uncertain. It is currently unclear if or when UK might accept the harmonised gas quality specification that has been implemented by other European networks. The DTI has yet to conclude how long it would take to replace the aging gas appliance stock which is preventing adoption of the harmonised specification, and what actions will be taken in this regard. This is directly related to the length of commitments that shippers will be prepared to sign up to and the economic viability of any investment. Greater clarity from DTI on its proposals would be welcome.

The Gas Scenario Sub-Group generated 81 possible gas quality outcomes based on three scenarios; of these, 42 outcomes fell outside of the Gas Safety Management Regulations (GS(M)R). However, there is no information or probability analysis to assess the likelihood of the scenarios occurring. BP considers that this lack of meaningful information on the probability of gas being unable to flow to the UK due to gas quality constraints will make the evaluation of long term commitments by shippers impossible.

Ofgem stated in its conclusions that market participants were 'not willing or not able' to provide National Grid with information to support whether their long term gas commitments will meet GS(M)R. Existing long term production or import contracts will almost certainly state that gas must meet GS(M)R. If there is gas that shippers are considering importing in future which will not meet GS(M)R, then this will come from spot deals or as yet unsigned long term contracts. Importers accordingly have no basis to declare the specification of gas from deals that are yet to be concluded. It is therefore unlikely that shippers are able to provide useful information in this regard.

BP is also of the view that if shippers do have information regarding their long term contracts and gas quality, they may not wish to disclose commercially sensitive information in an open forum. It may be more acceptable if shippers could provide information to an independent agency for collation. BP also notes that both Fluxys and GTS stated to Ofgem that they did not have access to information regarding gas quality in the long term. BP is surprised that these TSOs can plan, operate and optimise their networks effectively in the absence of assumptions regarding long term gas flows, and would encourage them to share these.

BP is interested to understand further the logistics of building a considerable sized ballasting plant at Bacton. BP is concerned that there may be issues with the ability to secure planning permission, the space needed to host such a facility, and whether there are any environmental constraints associated with building a plant at Bacton. These issues need to be carefully considered by National Grid, Ofgem, the HSE, DEFRA and DTI.

It could also be the case that a ballasting plant may only to be used in exceptional circumstances and therefore local cryogenic production may not be the most economic choice. It may be better to explore options such as the ability to tanker in nitrogen to Bacton and treat the gas on an *ad hoc* basis. If a ballasting facility is built by National Grid under those conditions, it may be more beneficial to adopt a low capex/high opex model to reduce the overall costs of a facility which may only be used rarely and for a limited period of time while UK moves to adopt the harmonised European gas quality specification.

Early discussions revolved around whether National Grid could re-configure its system at Bacton in a way that would allow near-spec gas to be blended by other gas streams at the terminal to bring the commingled stream within the GS(M)R. This option might also allow low-Wobbe South North Sea gas reserves to provide a blending service for high-Wobbe imported gas, which would help extend the life of the UK Continental Shelf. This option has the potential to offer a cheaper alternative to a processing plant and we would encourage National Grid and Ofgem to explore this further with UKOOA.

A discussion at early meetings included whether it would be possible to allow temporary gas quality excursions on the NTS, when deviations were small. Where gas is likely to be blended on-system prior to delivery at customer sites (as is done at Barrow), then this may pose a sufficiently low risk to safety to be considered by HSE as an acceptable change to the safety case. BP encourages National Grid, HSE and Ofgem to explore this further.

While BP considers that it is generally more favourable to leave the free market to deliver the optimum solution, it is known that the market does not always address low probability / high impact events. If Ofgem feels that the risks imposed are significant, then it may be appropriate to develop a supply security 'insurance policy'. This could, for example, introduce measures to stimulate provision of gas ballasting services beyond that dictated by market signals. However, before embarking down this path, a detailed cost/benefit analysis would be required, and great care would need to be taken to avoid undermining those market mechanisms which operate correctly.

Taking these concerns into account, BP considers that there may be few shippers prepared to make long term commitments to underwrite capacity in a blending or ballasting facility. Therefore, under the so-called 'hybrid' approach – which relies on user commitment for 100% of the available capacity - a ballasting facility is unlikely to be built. By comparison, the economic test for system entry capacity only requires 50% to be backed by user commitment. BP supports the UKOOA response recommending investigation of this lesser commitment. The balance of the capacity could be sold by regular auctions, right up to the day, enabling shippers to pay as they flow while accepting the risks which this might entail. In order to provide greater certainty for National Grid, the investment could be included in its regulated asset base. This model seems to offer a true hybrid solution and might increase the chance of delivering a pragmatic market solution.

In conclusion, BP considers that the work to date has been a very valuable start to analysing this issue but that further information will be essential to allow parties to determine the costs and benefits of investing in blending and ballasting facilities. In the absence of such information, more flexible approaches to investment recovery may need to be considered.

Please do not hesitate to contact me on the above number if you wish to discuss any of the points raised in this response.

Yours sincerely

Fiona Lewis
European Regulatory Affairs