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Gas Quality Scenario Development and Economic Regulation Workstreams - Conclusion

In response to the publication of a Conclusions document on 30th January, Interconnector (UK) Ltd. ("IUK") would like to offer the following observations.

IUK acknowledges Ofgem's initiative in the area of gas quality. IUK first highlighted the UK's position on gas quality as a potential problem for a country soon to be dependent on imports as early as 2001. While progress has been slow, significant steps have been taken, however IUK feels that a solution to the problem is still unlikely in the short to medium term.

IUK was encouraged by the level of involvement in the workstreams from non-UK based organisations throughout the work, indicating the level of importance attributed to this matter across North West Europe.

Scenario Development

As summarised in the Ofgem conclusions document there is considerable uncertainty regarding the likely future gas flow and quality scenario. While it is clear the UK will be dependent on imports the origin, volumes and quality of future imports could not be established. It was unclear whether Eassee-gas limits for gas quality would be incorporated in the transit grids immediately upstream of the UK, adding to the uncertainty faced by network users and operators.

This level of uncertainty is not uncommon in the liberalised energy markets where gas flows are dependent on the actions of multiple parties influenced not only by price but by many other factors. This uncertainty makes the planning of a large facility, which may or may not be required, very difficult. While operators may be willing to develop such facilities where adequate returns are on offer, the network users will be reluctant to invest, with the risk that facilities may be sized incorrectly and/or delivered too late.

Economic Regulation

While the Economic Regulation workstream managed to establish a logical sequence of events which would underpin a user commitment model the discussion was always subject to the underlying problems which arise when using a national mechanism to solve an international problem.

The proposed Hybrid 2 approach seeks to underwrite a National Grid investment by passing costs upstream beyond the remit of UK Authorities. As these costs pass beyond the jurisdiction of UK Authorities it is hoped that 'the market' will adequately apportion those costs to the importers who want to ship high wobbe index gas to the UK.

In the case of the Interconnector, IUK receives a co-mingled stream of gas on behalf of a number of shippers and transports this gas to the downstream grid operator. It is not possible within the Interconnector to identify the origin of each shipper's supply, nor the gas quality on a shipper by shipper basis. Any change to the Interconnector quality specifications can only be made if all parties agree. It is clear from the scenario work that in Belgium the supply sources have different gas qualities and therefore it is reasonable to assume that those shippers sourcing gas which meets UK

limits will be reluctant to change specifications in the Interconnector or in the Fluxys grid where such a change would involve additional cost.

IUK feels that at this point the user commitment model developed on a national basis is potentially flawed, in that costs arising in one Member State need to be apportioned to network users in another Member State. Furthermore network users will only be in a position to commit if they are fully aware of the commercial exposure that they face. A change to the entry specification at Bacton which is clearly a UK issue needs to coincide with changes to specifications in the Interconnector, the Fluxys grid and other countries in mainland Europe. These changes require extensive contractual amendments and therefore UK arrangements cannot be considered in isolation.

Given the scale of issues IUK believes that UK Authorities should keep all available options open to find a solution to this problem. These include:

- re-examine the decision to exclude the possibility that costs of any facility are passed to consumers,
- delay any changes given the high level of uncertainty surrounding gas quality and levels of imports allowing Network users more time to consider their alternatives
- engage neighbouring Authorities in order to co-ordinate changes to regulatory arrangements

IUK remains committed to working with its Shippers in order to move this issue forward and recognises the importance of finding a solution acceptable to all parties.

IUK does not consider this response to be confidential.

Yours sincerely

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