



Interconnector (UK) Limited

Interconnector (UK) Limited

56-58 Conduit Street
London W1S 2YZ

Direct Line: + 44 (0)020 7478 8421

Switchboard: + 44 (0)020 7478 8400

Central Fax: +44 (0)020 7437 4069

Email: waring.sean@interconnector.com

Website: www.interconnector.com

16th August 2007

Bruce Phillips
GB Markets,
Ofgem,
Level 4
9 Millbank
London
SW1P 3GE

Dear Bruce

The Economic Regulation of Gas Processing Facilities - key issues and initial thoughts

Interconnector (UK) Ltd. ("IUK") acknowledges Ofgem's initiative in the area of gas quality. Addressing the regulation of a facility designed to treat gas imports is a difficult task and progress has therefore been slow since the issue was first highlighted in 2001. Nevertheless significant steps have been taken to further understand the issue and consider options to address this problem.

Scenario Development

There remains considerable uncertainty regarding the likely future UK gas supply and quality scenarios. Predicting the future European gas flow patterns and quality is difficult for all players in the gas chain. Furthermore, it is un-clear whether Easee-gas limits for gas quality will be incorporated in the transit grids immediately upstream of the UK, adding to the uncertainty faced by network users and operators.

The changes to the UK supply pattern in the past two years have been dramatic. It is unsurprising that network users have so far been unwilling to commit to further investment. In spite of this, the forecasts for UK import dependence are also dramatic and IUK remains concerned that unless a resolution to this problem is reached in the near future, the UK could experience a supply shortfall. If this were to coincide with a cold or even average winter the impact on British consumers could be negative.

While the market has demonstrated that it will respond to manage risks it has not demonstrated that it is able to do this on time, every time. This level of uncertainty is not uncommon in liberalised energy markets where gas flows are dependent on the actions of multiple parties influenced not only by price but by many other factors.

While the uncertainty remains it is also equally clear that indigenous supplies are rapidly depleting in the UKCS and also the Dutch sector and that there is an increasing dependence on LNG.

User commitment

The fundamental issue debated in the work streams organised by Ofgem, has been whether the costs of developing a gas quality treatment facility are recovered directly from UK consumers through NGG's price control or whether the costs are recovered indirectly, through a user commitment model.

Ofgem have made clear their view is that costs should pass upstream, through a user commitment model, and there are strong arguments to support this principle, not least the fact that other importers have invested to treat LNG landed at regasification facilities. In the case of an LNG import terminal this decision is clear. The LNG imported needs treating to enter the grid. There are only a few parties involved each of whom requires gas quality conversion to a greater or lesser extent, depending on the source of LNG, and the ballasting plant is a small part of the overall LNG supply chain.

However, in the case of a grid to grid pipeline connection this is a very different situation; there are multiple parties some of whom are not shipping gas to the UK, title to gas changes many times between being introduced into one grid and being off-taken in another, some shippers source gas at market hubs and are unaware of the physical origin of that gas, not all gas requires treatment and therefore a conflict arises between shippers who do not require a service and those who might, treatment is not necessary in the upstream market and therefore efficiently treating and tracking becomes very difficult, tracking molecules to the system user who introduced them into a neighbouring grid requires the co-operation of operators further up the gas chain who are not incentivised to carry out this role.

In the case of the Interconnector, IUK receives a co-mingled stream of gas on behalf 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 original 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 on the continent which meets UK limits will be reluctant to change specifications in the Interconnector, or in the Belgian transit grid, if such a change would involve additional cost or risk to their service.

Way forward

This uncertainty of gas supply to the UK can be resolved through the construction of a facility by NGG at Bacton who is then able to recover its costs from within its regulated price control. The size of the facility and its impact on IUK rules/specifications are issues that will require further debate.

NGG is uniquely positioned to develop a gas processing facility. It is the only operator capable of managing a blending as well as ballasting solution and it is the operator closest to the consumer, hence minimising the need to transport inert gases in the upstream networks. The alternative is to leave the problem to the market which may not deliver a solution in a timely fashion for the next UK gas supply shortfall.

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



SEAN WARING
Commercial Operations Manager