STATOIL

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:csyk@statoil.com
Direct Line: 020 7410 6173
Direct Fax: 020 7410 6003

Bruce Phillips
GB Markets
Ofgem
9 Millbank
London
SW1P 3GE

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Dear Bruce

Re: Gas Quality Consultation

Statoil (UK) Ltd (STUK) has actively participated in the various gas quality workgroups, which have aimed to develop solutions to UK gas quality specification issues. Throughout these workgroups it has become clear that it is highly uncertain whether 'out-of-spec' imported gas would affect GB gas supplies. If it does, it may result in a material impact on price and security of supply in the UK. STUK welcomes the initiative to ensure that gas entering the UK is not constrained, owing to gas quality issues.

With decreasing indigenous production the UK needs to remain an attractive destination for new gas supplies, in order to ensure security of supply. If the cost of bringing this gas to the UK rises, it may become cheaper to deliver the gas elsewhere in Europe, where gas specifications are not as restrictive.

A factor, which needs to be considered for the medium and longer term, is the ability of blending and ballasting services to maintain the UK's ability to accept such gas. If the UK chooses to rely on blending and ballasting services, there may be times when it cannot accept imported gas at the import locations due to its inability to sufficiently treat the gas. Such an event could have a significant impact on the market. The provision of a blending facility at Bacton, for example, may be severely compromised if a single source of gas cannot flow as it will likely be necessary to curtail all sources of gas at Bacton as the blending opportunity will have been lost.

The optimal outcome is for security of supply to be maintained and the trading of gas between countries unencumbered by issues of gas quality. We feel that in the long term, adherence to the EASEE gas quality standard would help to achieve both of these goals and we would welcome a structured plan from the UK to set out how it will achieve this over time. In the shorter term, it is evident that treatment may be required but it is a question of how the cost of this should be allocated. The process for establishing the associated costs and the mechanisms for recovery should be as transparent as possible to ensure a clear signal to the market.

Response to specific questions

Question 3.1 *To what degree can commercial incentives alone be relied upon to deliver efficient investment in gas processing services? If not, what is a reasonable balance of risk between customers and users?*

STUK does not believe that commercial incentives alone can, in all cases, be relied upon to deliver efficient investment in onshore blending facilities. Had shippers enough certainty, with respect to the need for investment, then we might expect that, under the current arrangements, such shippers would have approached National Grid Gas (NGG) NTS for a feasibility study. To our knowledge, this has not been the case.

Question 3.2 *Would provision of gas processing services by NGG be the most cost effective approach? If so, please explain why?*

Given that the objective of this consultation is to maintain GB security of supply in the short to medium term, STUK would generally consider a blending approach to be the most cost-effective approach, in the short to medium term, however, ballasting might also be considered. This, however, already happens, an example of which, would be the recent installation of nitrogen ballasting at Easington, to deal with short-term issues.

It seems appropriate that NGG NTS are best placed as the most cost-effective provider of a blending service, owing to their crucial role in operating the system.

Question 3.3 *If NGG involvement is essential to the efficient provision of gas processing services, to what degree do existing arrangements ensure that NGG develops such services, if they are demanded? What other arrangements, if any, would be more appropriate?*

The existing arrangements should be sufficient to ensure that NGG develops processing services, if demanded. The problem here, of course is that we have seen historically that shippers have not had sufficient certainty to justify the considerable costs of requesting a feasibility study and there has been no indication that this is likely to change.

Question 3.4 *Given that existing market participants have already invested in gas import facilities including treatment of gas, how is the approach you favour consistent with preserving incentives for private investment in gas import and treatment facilities.*

A number of market participants have undertaken previous investment in gas import facilities and so it seems reasonable to consider the competition issues this might create. This is clearly a complex area, which would benefit from further exploration and discussion.

Question 3.5 *How much of the overall uncertainty attached to investment in onshore gas processing facilities is attributable to upstream issues, rather than future supply sources and demand? To what extent do potential difficulties in resolving such issues favour a processing solution (if required) upstream of the NTS?*

STUK recognises that ‘upstream issues’ as identified by Ofgem, might be considered to act as a barrier to blending at, for example, Bacton. We agree that changing this would be subject to significant and complex changes to contracts. With respect to ensuring that the imported gas complies with GSMR spec, we find it hard to envisage shippers agreeing to incur additional costs, when their gas can already flow, under existing arrangements.

It is difficult to ascertain how much of the overall uncertainty attached to investment in onshore gas processing facilities is attached to upstream issues, rather than future supply sources and demand as the significant uncertainty attached to the latter makes it difficult to quantify.

The extent to which resolving such issues favour a processing solution upstream of the NTS is, in some respect, demonstrated by the existing arrangements at Bacton and other import terminals, to ensure GSMR compliance.

Question 3.6 *Can commercial parties be expected to resolve the upstream barriers to the provision of onshore processing services, to exploit commercial opportunities? If not, what limits might there be to the barriers commercial negotiations might resolve and what is an appropriate role for Ofgem?*

Further discussion amongst relevant parties is clearly needed to facilitate understanding of the commercial opportunities, which might exist, before engaging in discussion to resolve potential barriers to exploit such opportunities.

Question 4.1 *How different do you consider the regulatory approach developed in the Economic Regulation workstream to be from a purely commercial approach? How important is it that NGG should be obliged to respond to market interest in gas processing services, as under the Economic Regulation workstream approach?*

The purely commercial approach is, effectively, what we have now, in that should any industry stakeholder identify a need for a processing facility, they are able to approach NGG for a feasibility study, the difference is, currently, NGG would not be obliged to undertake such a study.

Question 4.2 *Under a model based on user commitment, to what extent would enabling NGG to make additional investment in the service (subject to a different regulatory regime) introduce costs? What are these costs and would they outweigh the benefits?*

The view that a regulatory approach requiring full User commitment appears to offer customers the best protection against incurring the cost of inefficient investment in gas processing services must be weighed against the cost of high market prices and the risk of gas being constrained, owing to gas quality issues. Further work could be carried out attempt to quantify this.

Yours sincerely,

Christiane Sykes
UK Regulatory Affairs Manager* Please note that due to electronic transfer this letter has not been signed