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6<sup>th</sup> May 2010

Dear Andrew

**Gazprom Marketing & Trading Response to “Project Discovery – Options for delivering secure and sustainable energy supplies”**

Further to our discussions last year on the topic of gas quality, and in light of recent developments, please find below comments on Ofgem’s latest Project Discovery analysis, and proposals for a way forward.

We appreciate the efforts that Ofgem has made to include the gas quality issue in the latest analysis, “Project Discovery – Options for delivering secure and sustainable energy supplies.” You have correctly identified that there could be a risk of higher prices if “investment in gas ballasting . . . is not secured, and a gas quality arises.”<sup>1</sup> However we remain concerned that your analysis potentially underplays the timing of such a gas quality issue. In January this year Fluxys wrote a letter explaining that on 5<sup>th</sup> January and 6<sup>th</sup> January it was within a few hours of being obliged to reduce flows to the Interconnector. Fluxys had to use its linepack to ensure flows of UK compliant gas to the Interconnector because of the pattern of flows elsewhere in its system. Obviously use of linepack can only ever be a short term response; if the factors causing the problem persist, then flows of gas via the Interconnector will have to be reduced.

As Fluxys explained in its presentation at the seminar of 12<sup>th</sup> November, flows of Norwegian gas into Belgium, flows of gas at Eynatten, and supplies of LNG at Zeebrugge all have the potential to impact Fluxys’ ability to ensure that UK compliant gas reaches the entry point of the Interconnector at Zeebrugge. The events of 5<sup>th</sup> and 6<sup>th</sup> January merely confirm this, and occurred at a time when

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<sup>1</sup> “Project Discovery – Options for delivering secure and sustainable energy supplies.” February 2010. Paragraph 3.58. Page 26.

the UK was suffering from a bout of cold weather and problems with other sources of supply. It is difficult to predict when there will be such a combination of circumstances leading to a gas quality issue arising. It would be useful to understand more fully how Ofgem's analysis comes to the conclusion that there will not be a problem prior to 2016.

Furthermore, since the publication of the latest Project Discovery analysis, the EU Commission has launched a study to look at the costs and benefits of harmonising gas quality specifications across the EU. The study is not due to come up with recommendations until late 2012 / early 2013. As a result it is not clear if the conclusions will arrive in time for the UK to make a decision according to the timetable outlined in your document.<sup>2</sup> Given that we know that the UK is already not "harmonised" with other EU Member States, the UK would need to have a clear view as to how it would resolve this problem in order to make a timely decision in 2013. We know that the Department of Energy and Climate Change has reiterated its view that it does not plan to alter the GSM(R) specifications until 2020 at the earliest, and is awaiting the outcome of the EU study of gas quality specifications. However such an approach would not fit with the need to make a final investment decision in 2013.

As you know Gazprom believes that a regulated approach would be best, and we set out our reasons in our earlier response.<sup>3</sup> However, even if one believes that a "market solution" can be implemented, there needs to be a clear understanding of what the regulatory framework would be for such a market solution. As we have discussed in the past, companies will need to have a good understanding of such a framework as part of their analysis of the pros and cons of making any investment.

In light of the above we would urge Ofgem to restart the workshops that it organised in 2006/7 to develop further the regulatory framework for gas quality treatment, in line with the November 2007 forward plan published by the Department for Business & Regulatory Reform.<sup>4</sup> We would propose that these

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<sup>2</sup> "A decision would need to be made by the beginning of 2013 should a facility be required by 2016." Project Discovery - Options for delivering secure and sustainable energy supplies. February 2010. Paragraph 6.4. Page 74.

<sup>3</sup> "Gazprom Marketing & Trading Response to "Project Discovery – Energy Market Scenarios." 20<sup>th</sup> November 2009.

<sup>4</sup> "The Government accepts the case for a forward plan. It proposes to take the gas quality issue forward in the following way: working with Ofgem and HSE (and the industry as appropriate) to maximise commercial flexibilities in the period until 2020 (and beyond). This will include . . . Ofgem's exercise to develop a framework for National Grid to offer blending / ballasting services." BERR "Future Arrangements for Great Britain's Gas Quality Specifications – Government Response to consultation on future arrangements for Great Britain's gas quality specification." November 2007. Page 16. Paragraph 5.3 (i).

workshops involve the participation of DECC and Ofgem, as well as interested industry participants. The following issues would need to be addressed:

- Update of the status of the various initiatives regarding gas quality (e.g. DECC current view, Ofgem current view, EU Gas Quality Harmonisation study).
- Analysis of the nature of the problem, including update since the workshop in November 2009, understanding Ofgem's Project Discovery analysis, and understanding the recent analysis by the Department of Energy and Climate Change.<sup>5</sup>
- Preliminary analysis and discussion of the options for providing gas treatment facilities. (For example it may be that the most cost effective approach is a combination of plant at Bacton and Zeebrugge, or reconfiguration of the NTS at Bacton to enable blending in the way that National Grid does this elsewhere in the system to manage flows from Morecambe. This analysis will require the input of the relevant TSOs).
- Development of regulatory framework which will enable appropriate and timely investment in gas quality treatment facilities.

I hope the above comments are useful. We would be happy to meet with you and your team to discuss this further. If you have any queries please do not hesitate to contact me on ++ 44 20 8614 3036 or at [alex.barnes@gazprom-mt.com](mailto:alex.barnes@gazprom-mt.com).

Yours sincerely,

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<sup>5</sup> "Gas Security of Supply. A policy statement from the Department of Energy and Climate Change." April 2010. Paragraph E.20 Page 6.