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Friday, 31st August 2007

Dear Julian,

Re: Baseline Re-consultation, Substitution and Transfer and Trades

Following the extraordinary meetings of the Transmission Workstream to consider the re-consultation by Ofgem on the setting of the Entry Capacity Baselines for the UK Gas Transmission network, the new Entry Capcity Substitution regime and an enduring Transfer and Trades mechanism, Statoil (UK) Ltd (STUK) would like to make the following comments.

Baseline Consultation

Following the presentations given by Ofgem and National Grid on the process followed to set the existing baseline levels STUK have considered the methodology followed and have a number of questions and observations.

Setting the Supply and Demand level

In the presentation given by NGG it was explained that the demand level was set using the three '1 in 20' peak demand scenarios from the Transporting Britains Energy process. What remains unclear are the assumptions used to set these demand scenarios and how they relate to the behaviour of ASEPs. As was highlighted in the meeting it is important to ensure the demand level is set correctly as this will effect the levels of capacity that can/should be released.

Certainly since the original analysis was performed there have been changes accepted which will alter the regime in which the Distribution Networks operate. These changes may alter the nature of demand response. One such change is the change to the Interruption regime. Can NGG confirm what assumptions are made regarding interruptible sites in the demand levels and how the changes to the interruptible regime will impact on the setting of the Supply and Demand level.

Bi-directional Flows

During the last extraordinary meeting of the Transmission Workstream where NGG presented the methodology used to set the baselines, STUK asked what assumptions were made regarding the direction of bi-directional flows. The answer given in the meeting was that the representatives of NGG assumed that all bi-directional flows would be flowing gas into the network during a '1 in 20' peak gas demand scenario.

STUK would welcome more analysis regarding this assumption. Historical data illustrates that bi-directional sites have not consistently flowed gas to the network at times of peak demand.

Setting the Supply Level

Under the Winter Outlook process certain assumptions are made regarding the availability of Supply during the winter period. One such assumption is that because of the aging UKCS infrastructure only 90 percent of supply would be available in a 1 in 20 scenario. STUK would therefore like to further understand the appropriateness of using an assumption of 100% availability when setting the baseline levels and implications of taking a reduced supply availability into account.

STUK do not consider that taking the average of the resultant figures over the three supply scenarios can offer an appropriate means of calculating baselines. The three supply scenarios differ significantly in their approach to understanding possible supply of gas to the UK. Averaging resultant figures over the three scenarios cannot result in a realistic reflection of potential supplies.

Buy Back Risk

One of the implications of the level of supply will be the risk of buy back actions by the System Operator. Greater clarity is required on the level of this risk and the costs of any associated actions.

Ensuring the correct balance

The impact of the proposed changes on security of supply cannot be understated. If there is sub-optimal infrastructure to transport the gas throughout the network, this could directly lead to a system emergency with associated consequences.

Even if a 1 in 20 supply scenario is not experienced, if insufficient capacity is made available to allow gas to flow to the UK, Ofgem have previously stated the cost to consumers of gas not being made available to the wholesale markets to be billions of pounds.

Substitution and Transfer and Trades

Ensuring that the network is managed in an efficient and economic manner is clearly of benefit to Shippers, Suppliers and the consumers in the UK. As the level and allocation of entry capacity is clearly a highly important aspect of the UK Gas Transmission network regime it is therefore essential that prior to any changes being made the affects are considered carefully.

STUK have considered the high level options provided by NGG and believe that at this time all options should be discussed provided they can be developed to meet certain standards. Those standards are as follows:

Transparency

Ensuring any regime is sufficiently transparent ensures no party is disadvantaged and allows the market to make appropriate decisions. Any potential regime must be transparent allowing parties to reasonably predict entry capacity requirements and ensure bidding strategies correctly reflect the value of capacity. This will ensure capacity is neither under or over priced.

STUK would expect that some form of NPV test is needed to give the participants an appropriate level of information and transparency to allow them to adequately bid in the Entry Capacity Auctions. If there is no NPV test, we do not understand how a Shipper would be able to know what level they would be required to bid to signal the release of incremental entry capacity.

Stability

To allow economic and efficient investment decisions to be made by the market then stability is essential. Lack of stability will result in a risk premium being built into the financing of projects and/or deter investment.

Reduction in Capacity Levels

It is essential that the effects of exchange rates and the movement of capacity is thoroughly examined. The risk of capacity destruction occurring through high exchange rates impacting on security of supply and the free flow of gas to the UK market requires careful study.

NGG has raised the prospect of an exchange rate cap to mitigate some of this risk. STUK believes a cap of this kind may help to reduce the likelihood of inefficient network operation resulting from the transfer of capacity from location to location. The exact nature and level of any potential cap should be the subject of economic analysis to inform the discussion.

Timings and period of auctions

The timing of any auction regime and period for which capacity is made available could radically alter the effectiveness of the regime. STUK wish to understand further the implications of the proposed regimes and understand the likely effect on bidding behaviour.

Measurable

Only once the potential regime is understood and the affects can be ascertained can a logical and rational decision be made by the participants whether an option is going to be of benefit.

STUK believe it is essential that any decision to implement any particular solution on Substitution of Entry Capacity or Transfer and Trades is taken with as much knowledge as is possible. STUK would encourage both NGG and Ofgem to conduct as much analysis as possible on the effects of any proposed regime. For example it would be helpful in the consideration of the NGG suggested options if as much information, detail and analysis could be provided by NGG showing their view of both the positive and negative effects as soon as possible.

It has been STUKs view for a considerable period of time that the potential impact of these changes is so great on the wholesale markets and in the future on security of supply that an Ofgem Impact Assessment is required. Any analysis provided by NGG through this process could aid Ofgem in the production of an Impact Assessment which would then allow them to make an informed decision on Implementation.

STUK trust that our comments will be given due consideration and should you wish to discuss any aspect of this response further please contact me on the above number.

Yours sincerely,

Richard Street*
Statoil (UK) Ltd

**Please note as this letter has been delivered electronically this letter is unsigned*