

UK Government Energy Policy Review

Submission by TotalFinaElf Exploration UK PLC

UK Gas Supply and its Impact upon UK Markets and Security of Supply

In this submission TotalFinaElf Exploration UK PLC (TFEEUK) proposes that:

- **The investment needs for long-term capacity in the National Transmission System (NTS) are a UK strategic issue that need clear legislative direction to the regulator in terms of levels of security of supply and ultimate capacity requirements.**
- **NTS capacity should be made available on a long-term basis to support the requirement of gas field development for certainty of access to markets.**
- **The discussion on the methodology for the determination of long-term capacity and its allocation need to be resolved both urgently and in a way which results in producers and shippers paying no more than cost-reflective charges for the use of the NTS.**

INTRODUCTION

1. It is recognised that the PIU Energy Project Scoping Notes issued in August 2001 suggest a number of questions across the broad spectrum of energy issues. TotalFinaElf Exploration UK PLC (TFEEUK) supports the views that have been submitted by the UK Offshore Operators association (UKOOA) in response to these questions, but we would wish to take this opportunity to focus this submission upon the questions raised in the Gas – Initial Scoping Note, and in particular to the issues highlighted on UK gas demand/supply balance, auctions, and long-term investment (paragraphs 29 to 33 and 37 to 44). We will advance views on the measures that will be necessary to improve the conditions for the delivery into the UK of future UKCS developments and Norwegian gas, thereby alleviating the future dependency upon gas imports from Continental Europe and enhancing the energy security of supply within the UK.
2. We believe that due to the broad position that TFEEUK has with regard to Norwegian gas: as a producer (through affiliates); as an infrastructure owner (both Frigg, SEAL line and the Interconnector); and, as an operator for the Vesterled pipeline owners; we are able to provide a considered view of this issue based upon fact and internal group

consultation. In addition the TotalFinaElf Group has significant experience in the promotion, development and operation of trans-national gas pipeline activities elsewhere in the world, particularly in the southern cone of South America.

UK SUPPLY GAP

3. The UK already imports gas to meet winter peak demand, and most commentary, including DTI forecasts, suggests that the UK will become a net importer of gas with the next five to ten years.
4. This gas could be provided from several sources, and under most expectations would require additional links to Norwegian fields (to utilise the ullage that is and will be available in the UK offshore infrastructure) or additional interconnectors to Continental Europe.
5. In addition, although the Norwegian producers have recently commissioned the Vesterled pipeline facilities to deliver gas into St Fergus the continued provision of this service, especially at high volume rates should not be taken for granted.

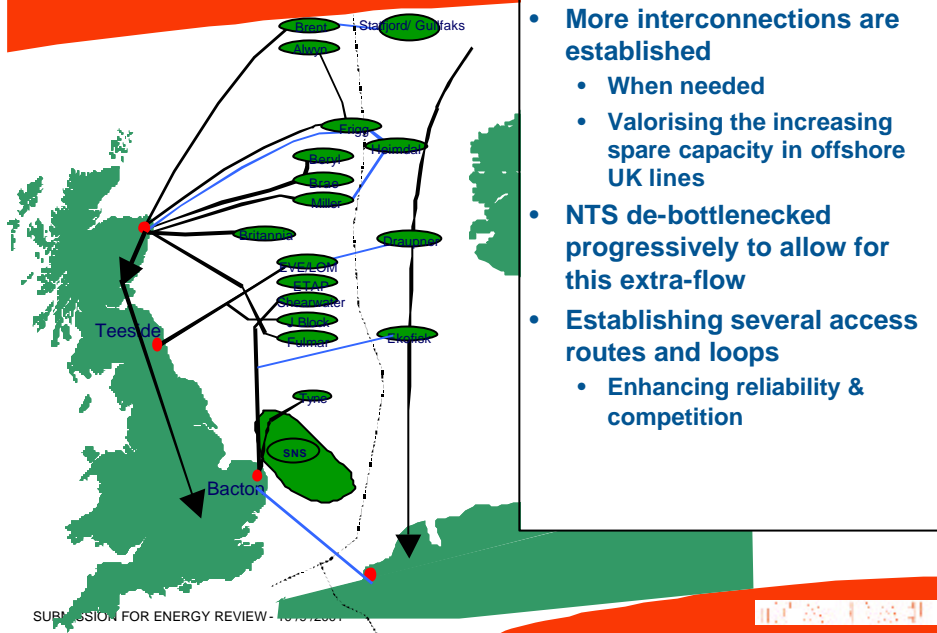
NORWEGIAN POTENTIAL

6. Although Norway is heading towards the full liberalisation of their gas industry it must not be assumed that all constraints on gas field development, production, and sales will be removed as approval of field development will still remain with the Norwegian Government. Nevertheless with the correct economic signals it is highly likely that more large gas fields will be discovered and put into production (for example Ormen Lange with approximately thirteen (13) trillion cubic feet of recoverable reserves and development approval expected by end 2002). Together with the construction of additional pipeline infrastructure to satisfy the higher export potential. Norwegian gas, therefore, has the potential to satisfy the anticipated UK supply gap for the foreseeable future with as much as 40-50 billion cubic metres per year of gas available to 2015.
7. Nevertheless, at present the Continental European markets may be perceived as having a greater attractiveness.
 - There will be a rising supply gap demand in NW Europe from 2005 exacerbated by any programme of nuclear power generation decommissioning;
 - There will be significant demands by the European Union Applicant Countries of Eastern Europe to meet social standards existing elsewhere in Europe; and,
 - There is a general demand from buyers to have Norwegian gas, and thus the perceived reduced supply risk, in portfolios.

UK STRATEGIC INTEREST

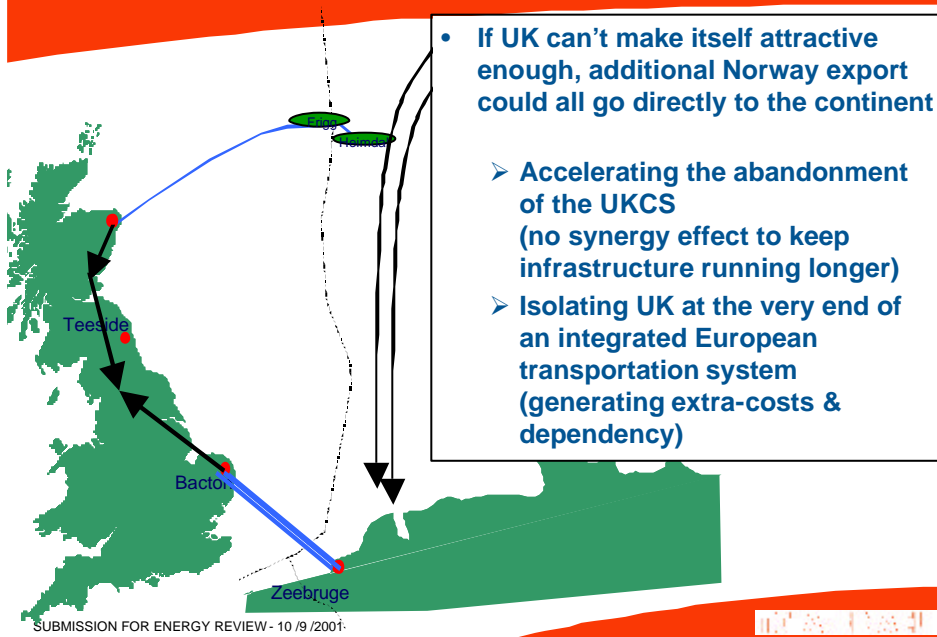
8. The UK has a clear strategic choice as to where it is positioned in relation to the future European gas grid.
 - It could become a transit route to Continental Europe for substantial volumes of Norwegian gas landed directly to a number of East Coast terminals, with UK demands being met in the process (the 'loop' scenario);
 - or the UK could find itself at the end of the Continental Grid having the least choice of suppliers, the highest prices reflecting the cost of cross-European and Interconnector transportation, and a concentration of imports on a single terminal, Bacton.
9. By achieving the former it is likely that wholesale prices in the UK will be less, or at worst equal to those in Continental Europe, thus providing commercial advantages to UK business interests. In addition diversity of energy supply will be increased thus improving the security of supply of UK energy demands. This can be achieved with little expansion of the current UKCS infrastructure due to the extent of pipelines and terminals that will have available ullage in the future. In addition enhanced opportunities will exist to satisfy the supply requirements of the UK petrochemical industries in the supply of base products.
10. For the UK to compete for Norwegian gas it is therefore necessary for the markets to become attractive to Norwegian sellers and offer conditions as good as, if not better than, Continental Europe.

Loop scenario – Optimum strategy ?



- **More interconnections are established**
 - When needed
 - Valorising the increasing spare capacity in offshore UK lines
- **NTS de-bottlenecked progressively to allow for this extra-flow**
- **Establishing several access routes and loops**
 - Enhancing reliability & competition

By-pass scenario – A worst case to be avoided



- **If UK can't make itself attractive enough, additional Norway export could all go directly to the continent**
 - Accelerating the abandonment of the UKCS (no synergy effect to keep infrastructure running longer)
 - Isolating UK at the very end of an integrated European transportation system (generating extra-costs & dependency)

11. For the 'loop scenario' to apply it is necessary that urgent action be taken to ensure that:

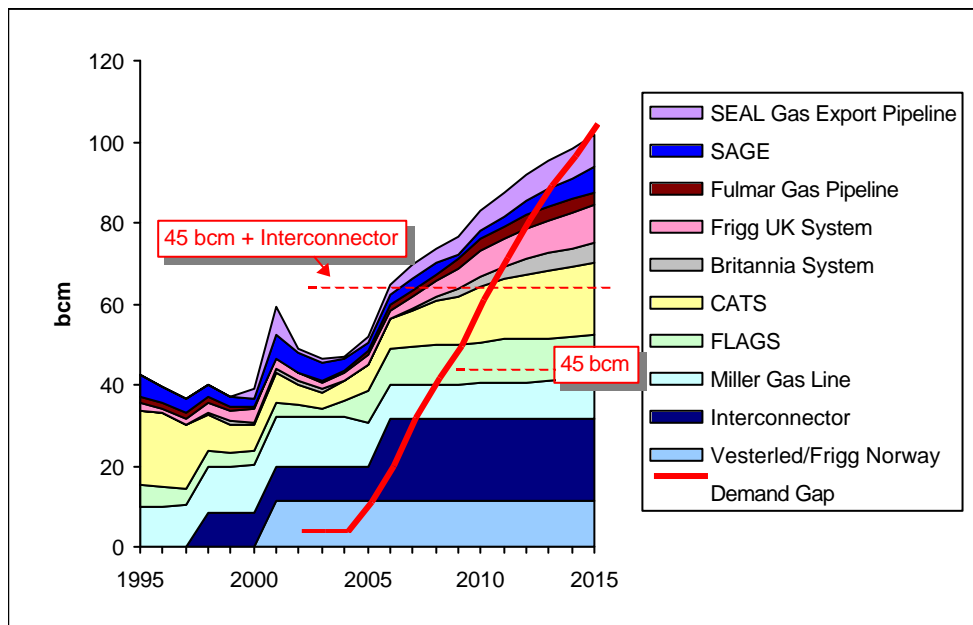
- There is certainty of the availability of long term onshore transmission capacity by the reinforcement of the National Transmission System, at least until 2020;

- There is certainty and stability in the cost of entry into the onshore transmission system at all terminals (although St Fergus is the largest concern at present)
- There is stability in market conditions including the regulatory regime.

INTRASTRUCTURE ISSUES

Offshore Infrastructure

12. The offshore industry has been successful in ensuring that there has been adequate infrastructure available to meet the needs of all developing fields. As a result of this approach and the likely ullage available in UKCS gas pipelines and terminals over the next 15 years, we foresee no difficulty in existing UK offshore infrastructure meeting the supply gap from both further UKCS developments and new Norwegian imports. This diversity of pipeline systems will also ensure that there is sufficient competition to promote the necessary cross-border links to enable the “capture” of Norwegian gas and to negate the need for any additional regulation than exists at present. This availability of UK ullage contrasts with the situation on the Norwegian Continental Shelf where existing capacity is full and any additional large-scale exports to the continent in order to supply the UK via Bacton would require additional pipelines.



Available Ullage in Existing Offshore Infrastructure

Onshore Infrastructure

13. This availability of competitive infrastructure and the consequential easy access to ullage does not exist onshore
14. The current regulatory framework puts an emphasis on the absolute economic and efficient operation of the National Transmission System. This encourages minimal investment for capacity that is absolutely certain to be used. Strategic surplus investment for the benefit of security of supply or the national economy is discouraged. These principles lead to the establishment of an under invested transmission system rather than the strategic over-investment required to achieve market stability and opportunity.

THE NATIONAL TRANSMISSION SYSTEM

15. It is therefore necessary to determine the mechanisms required to establish the infrastructure requirements. The current planning and investment processes are far from adequate. They do not give producers assurance regarding long-term requirements, nor do Transco receive adequate signals and assurance to determine levels of investment.
16. It is imperative that there is a transparent process that determines the NTS capacity requirements and the levels of investment to achieve this. This must then be balanced by processes to ensure that the capacity made available can be allocated in a manner that enables equal opportunity to all shippers at prices that reflect the cost of the provision of the capacity.
17. Capacity allocation could be on the basis of long-term contract carriage arrangements being established through volume-based auctions cleared at marginal cost. It must also be recognised that marginal producers should be expected to pay the cost of the provision of their required capacity.
18. A viable and fluid secondary market can then encouraged to facilitate the transfer of capacity between parties to tune the flow requirements as necessary.

CONCLUSIONS AND NEXT STEPS

19. TFEEUK conclude that they wish to see a number of positive actions being proposed by the Energy Policy Review.
20. The strategic importance of attracting new UKCS and Norwegian gas into the UK must remain as the primary objective, and the UK Government must promote the legislative processes for determining the necessary levels of energy security of supply and the ultimate capacity necessary to achieve this. Ofgem must then have the clear obligation to

promote the regulatory environment consistent with Government objectives

21. The methodology of long-term capacity determination and allocation needs to be resolved on an urgent basis. It is recognised that the industry has embarked on a series of meetings to determine the means to deliver these objectives. The proposed timetable for concluding these discussions of early 2002 is realistic, but it is more essential that the appropriate regime be developed even if this delays its introduction. Appropriately designed long-term volume based auctions may be an appropriate solution but the detailed design will be critical. In any event, failure to achieve these objectives may seriously impact upon the decisions of development and export route of new large gas fields, both in the UKCS and Norway, to the detriment of the UK.
22. The benefit of these steps should be for producers and shippers to pay cost reflective charges for use of the NTS, based on the economic rate of return for the necessary investments, allowing the UK to become a transit route for Norwegian gas and removing a potential impediment to the development of remaining UK gas reserves.
23. Success will depend on the active involvement of all gas industry stakeholders, led by the DTI, to create the necessary environment for the determination of capacity requirements and the means to allocate the installed capacity. TFEEUK intends to play its part in this process and will therefore be actively participating in all industry forums.