

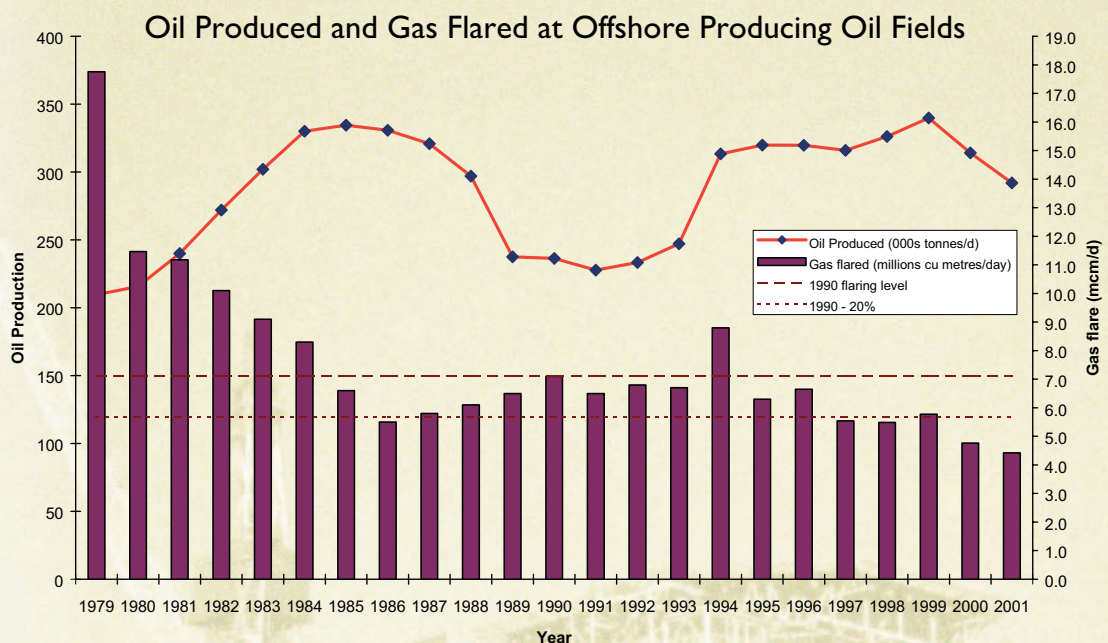
FTPTS BACKGROUND

DRIVERS OF THE SCHEME

UKCS Flaring History

Gas flaring is regulated by the DTI. Each year, the DTI capture negotiations with operators for the requirement to flare gas in the form of a flare consent. Flare consents, which are issued on a field-by-field basis, would typically comprise an element for safety purposes and for unforeseen contingencies, such as a compressor trip.

Between 1990 and 2001, there was more than a 30% reduction in offshore gas flaring by volume:



The industry has demonstrated that it has achieved substantial reductions whilst not compromising oil production. Indeed, oil production has actually seen a substantial rise in conjunction with the flaring decreases observed. These trends have mostly been achieved by increased efficiency of plant, adoption of best working practices and an increasing environmental awareness. In addition to this, the contingency element of flare consents has been reduced to reflect enhanced efficiency of operations.

It was recognised that if the downward trend in flare volumes released was to continue, further mechanisms would be needed. In addition, it is recognised that there is a contingency element built into the consent. It is this element that is likely to become the focus for where those further reductions can be found. The implementation of a trading scheme provides the framework for operators to trade their unused contingency, whilst maintaining oil production targets from their fields.

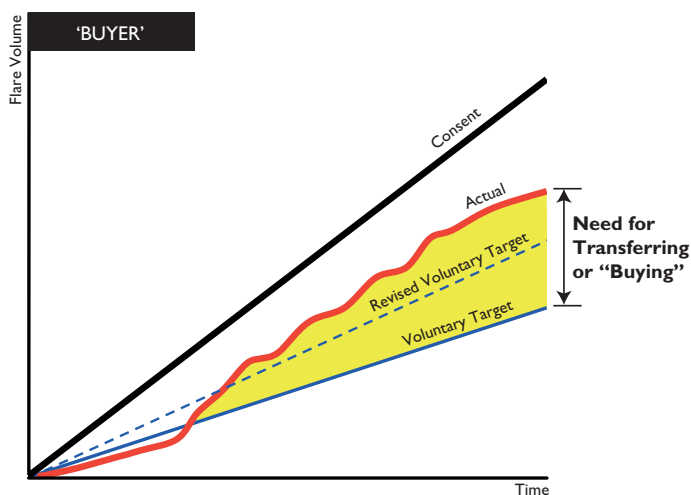
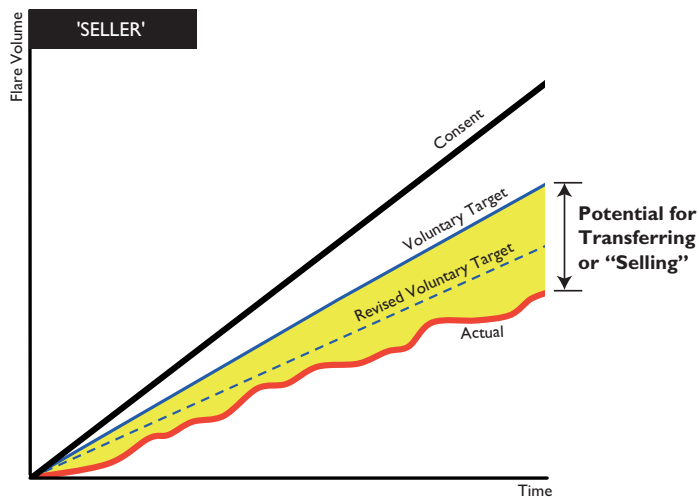
ADMINISTRATION



The Government and UKOOA have established guiding principles which should govern the development of environmental regulation in the future. The benefits of joining the FTPTS demonstrate that FTPTS fits well within these guiding principles:

- Continual improvement of the industry's offshore environmental performance should be guided as far as is practical by long term goal setting, considering all emissions streams holistically
- Methods for achieving environmental goals should be flexible, appropriate to the asset life cycle and promote innovation rather than relying on compliance against prescriptive standards or technologies
- Sound scientific analysis should be applied to assess environmental risk and impact. However, where there are threats of serious or irreversible damage, lack of full scientific certainty will not be used as a reason for postponing cost-effective measures to prevent environmental degradation
- In all cases, agreed improvements should recognise the balance between benefit gained and cost incurred, as well as the balance between emission stream trade-offs

Transfer of flare by assets operating within flare consents



- The process of developing environmental regulations should be transparent and include stakeholder consultation
- Penalties should apply if environmental laws are broken.

Original objectives were given by PILOT to the Steering Committee in 1998 and were called the Terms of Reference. These objectives were provided in order to gain experience and subsequently use this in:

- An emissions trading programme for flaring and
- An emissions trading programme for the sector as a whole as aligned with other trading initiatives such as the ACBE/CBI effort (the UK Emissions Trading Scheme- UK ETS).

During the development of the FTPTS, the progression of the UK ETS has been closely followed. Lessons learned from this have been incorporated, wherever appropriate, into the FTPTS.

The specific goals assigned to the Steering Committee were to:

- Present an interim set of trading rules
- Undertake a "Virtual" trading session
- Determine protocols for the measurement, monitoring, and verification of gas flared
- Identify trading rules and allocations
- Define legal issues fully, including partner/co-venturer issues and options
- Summarise necessary enabling legislation/regulations to be considered
- Prepare a business case for/against proceeding to 'actual' inter-company flare consent trading in 2001
- Monitor developments in related trading efforts to ensure alignment
- Ensure that participating companies are aware of the various trading programmes and techniques that are available for application of best practice
- Encourage involvement from other interested companies
- Promote the lessons learned from the pilot both within and outside the oil industry.

Governance

Although consents set the legal framework for the FTPTS, the Rules Group held several workshops in 2000 where industry representatives met with Government to determine the precise mechanisms for governing the scheme. The workshops facilitated discussions regarding the governance of the scheme and definitions of the mechanisms of transfer between 'Buyer' and 'Seller'. Given the non-financial status of the trading scheme, the word 'Transfer' was adopted as 'Trading' was thought to have monetary connotations. In addition, the legal aspects were deliberated and the rules under which the scheme would proceed were debated. In October 2000, agreement was reached and the first Rules Book was issued.

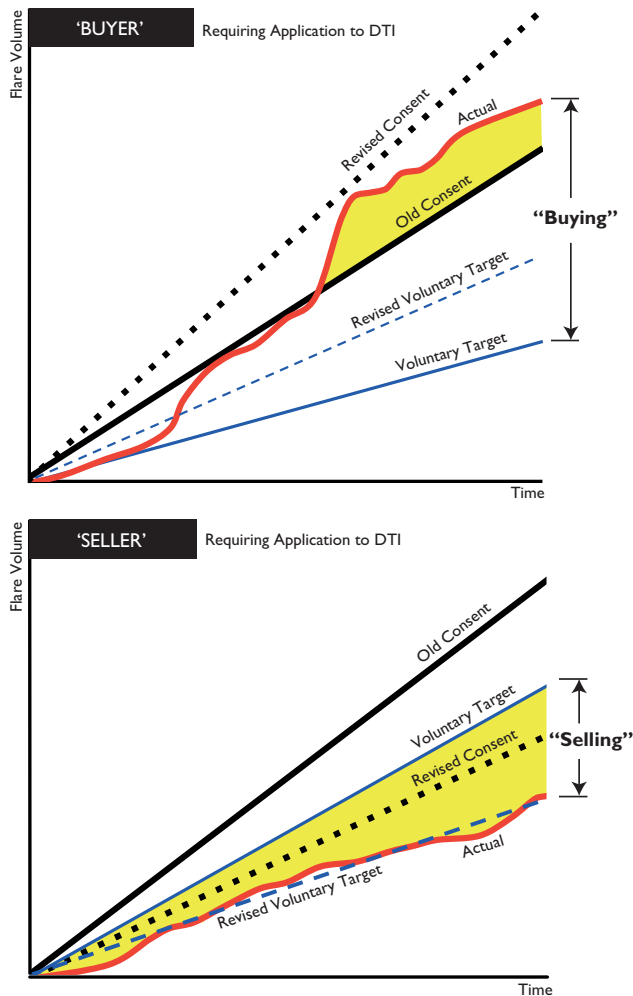


There are currently two scenarios under which the scheme operates and both are made possible through agreement between operators:

- Transfer of flare by assets operating within flare gas volume consents
- Transfer of flare gas volume by revision of consents.

The FTPTS scheme has provision for the scenario whereby an operator anticipates that their flare consent could be exceeded due to unforeseen operational upsets. The scheme allows for one or more operators to agree to transfer flare volume to another flare consent, provided the 'Seller' (or 'Sellers') reduces their flare consent by the commensurate amount. As the flare consents regime requires legal compliance, any revision of consent requires official agreement with the regulator. As brokers of the FTPTS scheme, the DTI are in the unique position of facilitating these types of transfers with the minimum of bureaucracy.

Transfer of flare by revision of consents



Partnership Equity

Legal advice was sought in order to clarify how partnership differences could be resolved. The DTI had originally advised that the legal owners of the flare consent were those parties named on the actual consent, not necessarily the operator. The FTPTS is possible because of the partnership agreements that are in place that allows the operator to act on behalf of the legal licencees when transferring flare gas volumes.

Additional experience will continue to be gathered from the UK ETS.

Monitoring and Measurement

The Monitoring, Measurement & Verification Sub-Committee hosted a workshop in August 2001 to produce guidance for measurement and verification of the Flare Transfer Pilot Trading Scheme. The document, 'Proposal for a Measurement, Verification and Discount Scheme' proposed that three measurement categories should be defined, each relating to the accuracy to which a flared gas quantity may be determined. By applying such discounted categories, a financial incentive is inferred on more accurate measurement of flare gas. Thus, market forces may be sufficient to warrant an economic case for installation of more accurate technology, thereby encouraging more effective trading.

The UK ETS has accepted UKOOA protocols for flaring measurement. Given that there is an objective to align with such trading schemes, it is possible that the FTPTS could also adopt this methodology. However, the FTPTS scheme has the flexibility to develop its own protocols further, if required.



SCHEME LAUNCH

The Rules Book was issued to all members of the FTPTS initiative and intentions to join the scheme were notified to the DTI. The FTPTS 'went live' on 1st January 2001, accompanied by a press release, issued by Amerada Hess Ltd on behalf of the Steering Committee.

Steve Messner of Amerada Hess Ltd, who was Chairman of the FTPTS Steering Committee at the time, stated that,

“The industry is committed to reducing flaring at offshore installations. Trading provides us with a mechanism for doing this in a way that maintains flexibility, essential in a complex operating environment, whilst achieving the overall goal. We believe this pilot scheme will provide us with valuable, practical experience and is an important step forward for the companies involved, the offshore sector and UK business more generally.”

On introduction of the new FTPTS scheme, the then Energy Minister, Peter Hain said

“The Government is keen to reduce offshore emissions and this pilot transfer system will help achieve this important goal by offering operators increased flexibility in their day-to-day management of offshore operations. This operational trial will provide industry with valuable experience and I welcome it. The incentive is there for operators to create a flexible and cost-effective trading mechanism. It should also reduce the levels of gas flared.”

The scheme encompassed almost 50% of the commissioned fields within the UKCS. Voluntary Asset Targets were set by individual companies for their own assets. Operators used internal methodologies to determine the level of the contingency element built into their consents that could be used to contribute to reducing flare volumes. This would likely be achieved by better anticipation of operational upsets. Although these targets were set at achievable levels, they still had to provide a stretched challenge for the asset such that real reductions could be gained.

