Gas Quality Economic Regulation workstream

Hybrid approach 1

Characteristics:

- The processing facility is built by National Grid and forms part of its regulated business. National Grid builds the facility to meet the demands of users as signalled in an initial tender and earns a standard rate of return on the assets.

Key features

- The facility would form part of National Grid's regulated asset base. It would therefore be subject to revenue allowances for capital expenditure (CAPEX) and operating expenditure (OPEX) and National Grid would earn a cost of capital consistent with the transmission price control.

- National Grid would conduct a tender process to obtain investment signals from the market to provide it with firm user commitment for the capacity at the facility. This would need to be consistent with the timeframes that it would take to construct the facility. As part of the auction National Grid could make available indicative reserve prices.

- National Grid may develop a test to assess whether bids were sufficient to justify spend on the facility based on user commitment demonstrated.

- On the basis of this tender process National Grid would determine the appropriate level of investment to meet anticipated peak flows.

- National Grid would make a level of capacity available, consistent with volumes bid for during the tender, to those parties that secured the capacity rights. The revenue from sale of this capacity would be treated as revenues under the TO price control, with any revenue over and above the maximum allowed revenue being offset by a reduction in other transmission charges.

  Q - If National Grid could provide additional processing capacity during certain periods could this be offered as additional capacity and treated as SO revenue?

- Anti-hoarding measures would be put in place to require that where parties did not intend to use their booked capacity they sold this to third parties through a secondary tender process.

- Tenders would take place on an annual basis to provide appropriate investment signals to National Grid following the initial investment.

Hybrid approach 2

Characteristics:

- The processing facility is built by National Grid and forms part of its regulated business. National Grid conducts an initial tender and has the opportunity to earn an increased rate of return if it invests appropriately in the facility based on the signals provided through the tender process as well as its own understanding of the required capacity of the facility.

Assumptions

- The facility would form part of National Grid's regulated asset base, as above.

- Initial indications for use of the facility would be determined through a tender process to determine user commitment.

- The tender process would provide National Grid with an indication of user commitment. On the basis of the tender process, as well as National Grid's understanding of the scale of gas quality issues it would determine the most appropriate capacity for a gas processing facility. As such, National Grid would be given the discretion to construct the facility to a capacity that it considers most appropriate.

- National Grid would be incentivised, through the transmission price control, to invest in the optimal volume of capacity at the facility. In this respect, incentives would be put in place with upside and downside risk and if National were to invest appropriately in capacity it would receive an upside reward but if it were to over-invest in capacity it would be penalised.

- A level of capacity would be provided by National Grid based upon the signals provided during the tender process. Any additional capacity that National Grid may invest in over and above this level could be made available to third parties through further tender processes.

- The processes relating to the availability of incremental capacity and the anti-hoarding arrangements would be consistent with the Hybrid 1 approach.

Unregulated approach

Characteristics

- A third party purchases land to construct a gas processing facility in response to market signals. The third party constructs and operates the facility but, as the facility is not regulated, does not receive any guaranteed revenue

Key Features

- To understand better the appetite of the industry for a gas processing facility at the location, the third party may carry out a tender process in which parties bid to demonstrate firm user commitment to purchase of the capacity.

- The third party could make a level of capacity available consistent with the user commitment demonstrated through the tender process or could decide that it considers additional capacity may be necessary to accommodate the level of processing of gas that would be required. However, as the venture is a commercial project the third party would be subject to competitive forces and therefore would be incentivised to ensure that it invests in the facility efficiently and consistent with industry demand.

- Any incremental capacity could be made available through additional tenders and similarly anti hoarding measures could ensure that any capacity which has been booked and may not be used is traded in a non-discriminatory fashion, through a secondary tender process.

    Q - Would a governance framework need to apply to the operation of this facility and associated anti-hoarding arrangements?