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Dear Clare

**Gas Quality Scenario Development and Economic Regulation  
workstreams Conclusions: a consultation**

energywatch welcomes the opportunity to respond to the issues raised by this consultation. This response is non-confidential and we are happy for it to be published on the Ofgem website.

Consumers expect their gas supplies to be safe, secure and reliable and delivered in the most efficient and economic manner. In order to achieve these expectations, those who sell and buy gas to supply the GB market must provide assurances to consumers that the quality of gas supplied is appropriate. It is unfortunate if these parties cannot provide even broad indications about the quality of gas which they intend to deliver to GB consumers on a transparent basis as part of this consultation.

We note the roles of the different oversight bodies in this regard. The Health and Safety Executive (HSE) has a responsibility to assure consumers that unsafe gas cannot enter the National Transmission System (NTS) backed up by National Grid Gas (NGG)'s obligation, subject to criminal sanction, to provide a safety case. The Department of Trade and Industry (DTI) must use its regulatory powers to assure consumers that offshore operators are not the source of unsafe gas. Ofgem has a separate responsibility to consumers to impose on NGG an appropriate licensing regime that ensures safe, efficient and economic operation of the NTS.

There are a number of interrelated considerations affecting consumers concerning safety, security and reliability of supply, and economic provision of gas.

## **Safety issues**

Ofgem has highlighted, and DTI has determined, that the gas safety regulations applicable in GB will not change before 2020. This is to ensure a low-cost solution for consumers, as using a broader specification for gas quality more compatible with gas sourced outside the UK Continental Shelf will require a wholesale replacement of gas appliances. We agree with DTI that it is uneconomic, unrealistic and detrimental to consumers to undertake wholesale replacement. Blending is cheaper.

After 2020, DTI has the option to amend current gas safety regulations allowing gas of a broader range of quality to enter the NTS, perhaps in line with EU developments such as EASEE-gas. If this is a long-term objective, in the meantime, and with the willing cooperation of appliance manufacturers, one way to address the issue may be to market compatible appliances to consumers. If these are economic to purchase, significant churn could allow many consumers to own compatible appliances. Future governments may need to separately address how to meet the needs of vulnerable consumers who may find affordability of new appliances difficult. However, consumers must have considerable notice of any intention to change. Otherwise, HSE, DTI and Ofgem retain responsibility for ensuring that no consumer is adversely impacted by retaining existing gas safety specifications.

## **Security and reliability of supply**

We note the work of the Scenario Development workstream in identifying future sources of gas and whether variable gas quality is an issue in those circumstances. Liquefied Natural Gas (LNG) may become a key source but we note that if LNG can be delivered to GB, if global prices deem this to be profitable, importation facilities may blend this gas before it enters the NTS. Gas of variable quality from Norwegian fields may be more problematic even though this is an important source. If variable gas quality becomes a significant issue in the short-term, without access to blending, there is a potentially adverse impact on security of supply and availability of gas for GB consumers. Similarly, a glut of compatible gas which is exported to the Continent could, in a tight supply/demand scenario, adversely impact supply and/or prices. That may create a disincentive to invest in the UK Continental Shelf.

Our concern is that the various scenarios point to a number of uncertainties and difficulties which may become exaggerated, particularly in tight supply/demand conditions. Appropriate supply margins need to be maintained but much of the investment in gas

infrastructure is driven by market forces and not with a view to holding strategic supplies to alleviate tightness unless there is a commercial driver. There is the additional issue that GB consumers are competing for supply with a wider consumer base on the Continent without the certainty of a locally available supply – stored or otherwise - held close to demand.

Ofgem must recognise that gas quality issues are only one piece in a complex gas supply jigsaw which could limit availability and delivery of gas, and lead to higher prices for GB consumers at any time, and which require an appropriate economic solution on a timely basis. While wholesale gas prices are currently falling, and this is a welcome development for hard pressed GB consumers, there are enough reasons highlighted in this paper for the opposite situation to develop, with materially adverse consequences for the same consumers. Ofgem, in furtherance of its primary duty to protect consumer interests, needs to be engaged in this debate as well as facilitating it. We are disappointed that Ofgem has been unable to reach a view based on the work carried out so far.

## **Economic issues**

We note the discussions of the Economic Regulation workstream outlined in the paper. If there is a high risk of incompatible Norwegian gas flowing to GB or being imported to GB after its diversion to the Continent, and this remains a significant supply source going forward, there is a good case for investment in blending and/or ballasting facilities in a timely manner. Consumers may be willing to pay a share of the cost but only if the facilities are built and operated on an economic basis (not inefficient investment – costs should then rest fully with NGG), and feasibility studies highlight that usage would not be low so as to create a stranded asset risk.

NGG seems to be the obvious choice for building and operating any facilities, as it can be accountable to users and consumers through its transmission licence and as the system operator for the efficient and economic operation of the NTS, and can also be incentivised to keep costs low to committed users of the facilities and to end consumers. The use of a ‘hybrid’ approach provides a commercial driver on NGG to deliver appropriate facilities and allows it to invest in extending facilities beyond a baseline user committed level. Any regime, initiated by licence condition and a ‘user pays’ study, must provide for appropriate economic means of allocating capacity, with effective ‘use it or lose it’

provisions and secondary trading of unused capacity to prevent underutilisation of the facilities. NGG and potential users are much better placed than GB consumers to determine whether, and to what extent, the facilities will be necessary and how to manage, and, therefore, pay for, associated risks.

We believe this is preferable to full socialisation of costs (the pure regulated approach), which would increase costs to consumers without incentives on NGG, or to a market driven (unregulated) solution. As noted above, a fully commercial solution may never develop, even where there is a recognised need, if developers, or their financial backers, consider the returns to be insufficient or not worth the risk. The lead time required to build facilities of this nature also means that, at some point, there must be irrevocable commitment to proceed with the project, whatever its perceived risk/return profile. The hybrid solution at least bases utilisation on user commitment with risks of underutilisation lying with those users and NGG.

Going forward, we will continue to keep these issues under review as and when they are raised, always considering the possible impact on consumers.

We would appreciate being kept informed of the progress of the consultation and any related issues to enable us to comment as the need arises.

If you do wish to discuss our response further please do not hesitate to contact me on 0191 2212072.

Yours sincerely

Carole Pitkeathley  
Head of Regulatory Affairs