



Ofgem Consultation – the economic regulation of gas processing services – key issues and initial thoughts
Comments from Association of Electricity Producers

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The Association welcomes the opportunity to provide comments on this initial thoughts consultation. We recognise the importance of securing diverse gas supply routes to the UK at a time of reducing indigenous production and consider gas quality issues to be relevant. Secure gas supplies will in turn provide for security of the electricity supply as the CCGT fleet makes up a growing proportion of installed generating capacity. Also clearly defined gas quality parameters are essential in order for generators and gas turbine manufacturers to maintain turbine performance and efficiency. We welcome Ofgem's initiatives to progress this debate.

The Association of Electricity Producers (AEP) is the UK trade association representing electricity generators. It has some 90 members ranging from small firms to large, well-known PLCs. Between them they represent at least 90 per cent of the transmission connected generating capacity and they embrace nearly every generating technology used in the UK.

Question 3.1 To what degree can commercial incentives alone be relied on to deliver efficient investment in gas processing services? If not, what is a reasonable balance of risk between customers and users?

The Association considers that commercial incentives are generally sufficient to drive efficient investment. However for this to be the case there needs to be a clear stable regulatory framework and transparency of information that can influence investment decisions. There are several examples in the UK where investment in gas processing facilities has been made on a purely commercial basis, including the new LNG import terminals, at Point of Ayr and more recently at Easington for Ormen Lange gas. These decisions were driven by knowledge of the source of supply of the gas and of the entry requirements for gas to enter the NTS alongside the GS(M)R parameters. This information was available and led to decisions being made at the outset or early stages of the investment project. The key difference with the possible need for gas processing facilities at Bacton is that the requirement and its timing is uncertain, given the uncertainty over the initial supply source and therefore quality of the gas. There is also uncertainty over whether the entry requirements and GS(M)R may change in the future beyond 2020, and the effect of the CEN mandate, these could affect the useful life of any facility and pay-back times. All this coupled with the fact that this would be a retro-fit operation leads us to consider that in this case commercial incentives may not

be sufficient to ensure that investment in appropriate facilities actually takes place.

We would also observe that irrespective of how investment is put in place the customer will pay the costs either directly or indirectly even though competitive supply pressures may minimise these. It is also the case that if gas were to be in short supply due to gas quality constraints following inadequate investment prices would rise and customers and UK plc would face these costs too.

Question 3.2 Would provision of gas processing services by NGG be the most cost effective approach? If so please explain why

For the reasons stated above particularly that the commercial incentives may not be sufficiently strong to ensure purely commercial investment in gas processing facilities and the fact that NGG can take more of an overview of all the gas flowing at a terminal, investment by NGG could be the most appropriate approach. An initial step may be to consider socialising the costs of the initial feasibility study.

Question 3.3 If NGG involvement is essential to the efficient provision of gas processing services, to what degree do existing arrangements ensure that NGG develops such services, if they are demanded? What other arrangements, if any, would be more appropriate?

It is not clear that the current arrangements would require NGG to invest in facilities even if the market demands them, nor is it clear how it would recover the associated revenues and what the incentives for efficient investment would be, whether this is under a regulated or user commitment type approach.

Question 3.4 Given that existing market participants have already invested in gas import facilities including treatment of gas, how is the approach you favour consistent with preserving incentives for private investment in gas import and treatment facilities.?

We agree that this is a difficult issue and that it would be important to preserve incentives for private investment in gas processing facilities where necessary. However, even if the costs at Bacton were socialised, so long as GS(M)R does not change then incentives for investment in treatment facilities at entry points seeking to bring in gas from known sources that are outside GS(M)R will be maintained.

Question 3.5 How much of the overall uncertainty attached to investment in onshore gas processing facilities is attributable to upstream issues, rather than future supply sources and demand? To what extent do potential difficulties in resolving such issues favour a processing solution (if required) upstream of the NTS

We consider that the specification of gas carried by IUK and potentially other import pipelines is a key issue and presents something of a 'chicken and egg' situation. A processing facility at Bacton may not be required until IUK can carry non-GS(M)R (as currently defined) gas, but that the commercial changes that IUK shippers will need to agree are unlikely to progress absent some certainty that non-GS(M)R gas can be accepted into the NTS after processing.

Question 3.6 Can commercial parties be expected to resolve the upstream barriers to the provision of onshore processing services, to exploit commercial opportunities? If not, what limits might there be to the barriers commercial negotiation might resolve and what is an appropriate role for Ofgem?

We would expect commercial parties to be able to resolve these contractual issues if the incentives are clear and strong enough, however we are not sure that they are, in which case customers will pay through higher prices. We agree that Ofgem's role should be in influencing other regulators.

Question 4.1 How different do you consider the regulatory approach developed in the economic regulation workstream to be from a purely commercial approach? How important is it that NGG would be obligated to respond to market interest in gas processing services, as under the economic regulation workstream approach.

A pure commercial approach may be more fragmented, whereas NGG would be able to take a more holistic view of the requirements which would be more likely to lead to a more efficient outcome. We agree that it would be important for NGG to respond to any market signals generated.

In any way forward a balance will need to be struck between protecting customers' interests by securing gas supplies whilst ensuring that adequate investment is made to ensure that gas can be delivered to the UK at reasonable cost. In this regard consideration will need to be given to the relative risks and costs to customers of over or under investment in such facilities and the consequence of potential supply deficits.

Question 4.2 Under a model based on user commitment, to what extent would enabling NGG to make additional investment in the service (subject to a different regulatory regime) introduce costs? What are these costs and would they outweigh the benefits?

It would seem to be pragmatic to allow NGG to invest to a level above that signalled by participants, as it is possible that NGG may have a better overview of the likely requirements and potential for 'extreme gas quality days'. Clearly this should be subject to a different regulatory regime than that signalled by participants but economies of scale may mean that the marginal

costs of extra processing capacity are not too large. We recognise that this would introduce regulatory complexity and may suppress user incentives to signal the need for a facility, but we consider the risk and costs to customers of the UK being short of gas are likely to outweigh these concerns.