Transmission Price Control Review – Gas Entry Baselines: Ofgem's re-consultation, ref. 234/07

Introduction

Oil & Gas UK is the trade association which represents the offshore oil and gas exploration and production industry (operators, non-operators, contractors and suppliers)[1] in the United Kingdom. We are pleased to have the opportunity provided by this re-consultation to contribute to the continuing debate about capacity at the various entry points to the National Transmission System. There are, of course, some substantial changes in the sources and means of supply of gas to the market in Great Britain which make this review all the more pertinent.

We entirely support Ofgem in its desire to see the system operated in an efficient and economic manner, but we are far from sure that delivery is matching this laudable intention. There would appear to be a number of inter-related reasons for this and we elaborate upon these below. In particular, we are conscious of the importance of treating the various measures regarding entry capacity within the TPCR as a single package and not as separable items. It is in this context that success, or otherwise, will have to be judged.

Furthermore, it is not entirely clear to us from the consultation document that the nature and extent of the problem have been fully defined, nor that the proposals will deliver benefits which outweigh their adverse effects. The premise is stated to be "supply substitution" on account of declining UKCS production, but we submit that this cannot adequately describe the totality of the circumstances.

The NTS needs to be able to accommodate the changing pattern of supplies from the UK's continental shelf (UKCS) – see below for some more detail – and to attract new imports in order to meet anticipated demand. This requires certainty for producers and shippers about both longer term access and shorter term flexibility, at affordable prices. Traditionally, energy transmission networks have had a degree of resilience built into them to help ensure security of supply and, therefore, to protect a broader, national interest.

Overall Capacity in the NTS

According to NG's document "Development of NTS Investment Scenarios" published in July 2007 as part of its TBE process, NTS demand is forecast to grow by 3.5% a year during the next ten years, with peak demand rising by 2% a year. This mainly reflects the construction of 12.6 GW of gas fired electricity generating capacity, replacing older coal fired and nuclear power stations which are having to be retired, and higher exports to Ireland and the continent.

[1] Well known names include Amec, Aramark, BG, BHP Billiton, BP, Centrica, Chevron, ConocoPhillips, ENI, E.On, ExxonMobil, Gaz de France, Halliburton, Maersk, RWE, Schlumberger, Shell, Total and Wood Group.

At the very least, this suggests that the NTS may well need further investment in the next few years and/or de-bottlenecking at certain critical locations to ensure that there is sufficient capacity and, crucially, flexibility in the system to respond to changing patterns of supply and demand. We firmly believe that such flexibility is necessary for the operation of an efficient overall system.

The concern which we have in all of this is that, with the obvious exceptions of the forthcoming increases to accommodate new flows of gas at Milford Haven and Isle of Grain, the TPCR has concentrated on the allocation of capacity between the various entry points, seemingly without any assessment of the overall adequacy of the capacity in the NTS as a whole. With this re-consultation in progress, it would be timely to assess this fundamental point and assure all participants that there are no significant shortfalls evident. We would strongly recommend Ofgem to consider doing this.

In this context, it is also worth remembering that, according to Ofgem's own information, transmission costs only account for some 2% of the final bills paid by consumers of gas.

Modelling of the NTS

In addition to assessing the system's overall capability is the question raised in the re-consultation document of an independent audit of NGG's modelling. We also raised this matter when we wrote to yourselves in February 2007 (then as UKOOA) and you replied in April. Given the scale of the concerns expressed during the recent workshops and in written submissions, it is not surprising that this has come to the fore again.

There is clearly a sense within the industry as a whole that participants simply do not have available the necessary information upon which to make informed judgements either about the system's overall capability or about individual entry capacity; in other words, there is a lack of transparency in the process. Given that there is no independent check of these essential requirements, we are all totally dependent on the modelling done by NGG which, naturally, involves degrees of subjectivity on account of the assumptions being made. This cannot be satisfactory any longer, either from market participants' points of view or with respect to the security of gas supply.

Such an independent check would not be intended to supersede Ofgem's work, but to reinforce it and give that degree of assurance which is now so clearly being sought. We believe that it would also help Ofgem.

Long Term v Short Term

UKOOA as it was, now Oil & Gas UK, has for many years supported Ofgem in the concept of long term auctions for allocating entry capacity in the NTS, but we have consistently advised against placing too much reliance on these for the purposes of identifying future investment needs. There are various other means

and information available in the market place to assist this identification, not least a much improved TBE data gathering exercise which NGG undertakes in the early part of each year.

The gas industry throughout the world has been founded on long term investment decisions whose consequences are usually measured in decades. Whilst the development of competition has facilitated the emergence of short term capacity and commodity markets, the underlying need for long term investment continues, especially when security of supply is considered.

In the shorter term, however, both marginal capacity and flexibility are required. Investors look for regulatory and fiscal predictability, but it would appear to Oil & Gas UK that we are at risk of developing a market system whereby certainty and stability are diminishing, rather than rising; the rules are changing too frequently and complexity is ever growing. An example is the proposal for capacity substitution between entry points: in principle, this looks sensible; however, the mechanics will probably favour longer term capacity requirements (e.g. for LNG terminals or new pipelines) where certainty of access is required, but will be damaging for short term capacity (a few years), because they would remove or restrict an important element of flexibility, despite the countervailing effects of transfers and trades.

The consequences for future developments on the UKCS, where fields may well be squeezed by the mechanics of substitution, are indicated in the section below.

UKCS Production – Security of Supply

The United Kingdom is clearly becoming more dependent on imported gas, but it would be a grave mistake to assume that the remaining potential of the UK continental shelf (UKCS) is of little or no significance. Apart from those fields under development or in production, there are more than 60 small gas fields in the southern North Sea alone, with aggregate reserves in excess of 100 bcm, whose development is not yet possible because of poor economics, technical difficulties and the like (this figure of 100 bcm excludes reserves in the “yet to find” category).

The landing points for this gas are probably Bacton, Theddlethorpe and Easington and the industry’s experience is that, with time, ways and means will be found to overcome many of the obstacles to development. However, given the uncertain timing and nature of these reserves and their likely production profile (rapid build-up, short plateau and quick decline, typically all in the space of a few years), it is most unlikely that developers will be able, for economic reasons, to bid for and secure long term capacity at entry points for such fields; they will need the maximum of short term flexibility and predictability.

Furthermore, to the west of Shetland (WoS), there are known reserves amounting to some 140 bcm (i.e. excluding “yet to find” reserves), but currently

there are no pipelines which can deliver this gas to market, the landing point for which would almost certainly be St. Fergus. The government's established policy is to recover as much of the oil and gas as is economically possible from the UKCS. To prevent these reserves WoS remaining undeveloped and becoming "stranded" because of their marginal economics, means need to be found to ensure that all seemingly spare capacity at St. Fergus is not substituted in favour of other entry points and that sufficient capacity and flexibility in the NTS are maintained.

In a similar vein, two other important matters need consideration, in our opinion, with respect to entry capacity and security of supply:

i) possible new, offshore gas storage projects;
ii) the potential for new sources of imported gas, whether delivered through existing pipelines or new / newly configured infrastructure.

The significance of all of this is that there is much potential still to be considered with the UKCS and there needs to be flexibility in the NTS to manage a variety of possible, but currently uncertain, outcomes with regard to both our own production and further imports and storage. In addition, there are inevitable consequences for the security of gas supplies.

Summary

- **Oil & Gas UK fully supports Ofgem in its wish for an efficient and economic national gas transmission system.**
- **However, there needs to be a clearer definition of the perceived problem to be solved than is contained in the current consultation document.**
- **The price control regime should be considered as a whole, not just in its individual parts.**
- **We strongly believe that it is time for an independent assessment of the overall adequacy of the NTS and its behaviour under differing patterns of supply and demand.**
- **Too much reliance is being placed on long term auctions for the purposes of identifying future investment needs. Other available means and information should be used, as well.**
- **Participants need certainty about both longer term access to and shorter term capacity and flexibility in the NTS, at affordable prices.**
- **There is much gas still to be recovered from the UKCS, but from a wide variety of fields, many of which will have short production lives, thus preventing the booking of long term capacity.**
- **Security of supply should also be taken into account – energy networks need a degree of resilience built into them for these purposes.**

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