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for energy consumers

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Dear Mr Foster,

**Decision on “The Islay Natural Gas Project” submission to the Initial Screening Process of the 2015 Gas Network Innovation Competition**

This letter is to notify you of our<sup>1</sup> decision on The Islay Natural Gas Project you submitted to the Initial Screening Process (ISP) for the Gas Network Innovation Competition (NIC).

We welcomed a submission from an independent gas transporter this year. We think that this project has some good ideas and some potential to be commercially and technically innovative. However, I am afraid the submission did not demonstrate sufficiently that the project meets the ISP criteria. We have therefore decided that the project submission has failed to meet the Eligibility Requirements<sup>2</sup> in sections 4.7 to 4.19 of the Gas NIC Governance Document (Gas NIC GD<sup>3</sup>). Our reasons for this decision focus on the ISP criteria and are set out below.

While we cannot prejudge a decision on a future submission, we would welcome a more developed bid to the Gas NIC next year.

**Background – The ISP Eligibility Requirements**

Within the current price control framework, we introduced the NIC. This is an annual competition to fund selected innovative projects involving network companies and their partners which could deliver low carbon and/or environmental benefits to customers. All proposed Gas NIC projects must pass the ISP before they can be developed into Full Submissions to be evaluated by the Expert Panel and considered by us for funding.<sup>4</sup>

A potential project must meet certain requirements which are set out in the Gas NIC GD. In order to succeed at the ISP, a project must meet at least one of the specific requirements (paragraph 4.8 of the Gas NIC GD) and all of the ISP criteria (paragraphs 4.9-4.19 of the Gas NIC GD) under the Eligibility Requirements.

The specific requirements are that a NIC project must *“have the potential to have a direct impact on a Network Licensee’s network or the operations of the GB system operator and involve the Development or Demonstration of at least one of the four specific requirements”*:

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<sup>1</sup> The terms “we” “us” and “our” are used to refer to the Authority. The Authority is the Gas and Electricity Markets Authority. Ofgem is the Office of the Authority.

<sup>2</sup> The term “Eligibility Requirements” has the meaning given to it in the Gas NIC GD.

<sup>3</sup> <https://www.ofgem.gov.uk/ofgem-publications/94392/gasnic-finalclean-pdf>

<sup>4</sup> Capitalised terms used in this letter which are not otherwise defined have the meaning given to them in the Gas NIC GD.

- *a specific piece of new (i.e. unproven in GB) equipment (including control and communications systems and/or software);*
- *a specific novel arrangement or application of existing gas transmission and/or distribution equipment (including control and communications systems software);*
- *a specific novel operational practice directly related to the operation of the gas transportation system; or*
- *a specific novel commercial arrangement.”*

In order to pass ISP, a Network Licensee must also “*demonstrate that the Project meets all of the following four ISP criteria:*

- *accelerates the development of a low carbon energy sector and/or delivers environmental benefits while having the potential to deliver net financial benefits to existing and/or future network customers;*
- *delivers value for money for gas customers;*
- *creates knowledge that can be shared across energy networks in Great Britain (GB) or create opportunities for roll-out across a significant proportion of GB networks; and*
- *is innovative (i.e. not business as usual) and has an unproven business case where the innovation risk warrants a limited Development or Demonstration Project to demonstrate its effectiveness.”*

## **The proposed project**

Your project submission for funding under the Gas NIC this year stated that the project aimed to provide access to natural gas for residents and businesses on the Isle of Islay. The project would create a new independent gas network on Islay to transport gas to customers. It would compress natural gas taken from the national transmission system (NTS) and deliver it by road trailer to Islay where it would be injected into the new gas network.

## **Our assessment**

Following the project’s submission we asked you some questions as we were unclear how the project met both parts of the Eligibility Requirements. We considered the answers to these questions in our assessment.

Despite the additional information you provided in response to our request, we are not satisfied that your proposal meets the Eligibility Requirements. It is the applicant’s responsibility to provide all of the necessary information to assist with the assessment of the project proposal, and we do not think there is enough information in your submission or in your responses to our questions.

### *Specific requirements*

The ISP submission, and the responses to our questions, said that the project would meet three of the specific requirements. We understand how this project could meet one of those three specific requirements (a specific novel commercial arrangement) but you have not presented sufficient evidence to demonstrate that it meets the other two requirements.

To help inform any future submission, we have given our opinion on the extent to which the proposal meets the specific requirements below.

- *a specific piece of new (i.e. unproven in GB) equipment (including control and communications systems and/or software)*
  - You say that novel daughter stations will be constructed where compressed natural gas (CNG) will be decanted from trailers into a lower pressure (7 bar) gas grid. We do not think that these stations are novel because they are very similar to

arrangements in place for the Statutory Independent Undertakings (SIUs). Neither the submission nor your further response fully articulated the specific piece of new equipment the project proposes to adopt.

- *a specific novel operational practice directly related to the operation of the gas transportation system*
  - You suggest that the operational practices related to daughter stations are entirely novel and that the proposal to offtake gas from an NTS block valve and transport it by road to a remote network is a novel form of offtake and a novel form of transportation. The proposal also stated that the type of CNG trailers used in the project would be novel. The submission has not presented evidence to demonstrate knowledge of the existing practices that are in use and what specifically will be novel about the proposed practice.
- *a specific novel commercial arrangement*
  - You said that the commercial arrangements for existing independent gas transporter (IGT) networks assume that the IGT network is physically connected to an existing gas transporter network but this would not be the case on Islay. We can understand the potential commercial innovation here and we agree that the project meets this requirement. However, the submission could have gone further to explain how the proposed arrangements would be sufficiently different to commercial arrangements for other independent gas networks.
  - You suggest that an unregulated approach would be feasible and that would of itself be novel for gas supply in GB. The proposal states that, if regulated, it would require modifications to the Uniform Network Code (UNC). We do not think that the requirement to modify the UNC in itself demonstrates a specific novel approach.
  - You also stated that no Gas Distribution Network involvement is proposed and hence the associated commercial arrangements which are already in place at the SIUs will not apply at Islay. The submission could have explained more fully how the commercial arrangements would be different from those at the SIUs.
  - In addition, you claimed a novel commercial arrangement would be in place to ensure that domestic customers obtain a 100 per cent firm gas supply. The project proposes to use interruptible contracts to ensure this, but interruptible contracts are well-established in GB and we do not consider this part of the project proposal to be novel.

#### *ISP criteria*

Although we were satisfied that the submission could meet one of the specific requirements, the proposal fails to meet three of the four evaluation criteria set out in the Gas NIC GD. It must meet all four of them to pass ISP. The submission was particularly weak with respect to criteria (a), (b) and (c). We outline our concerns about the extent to which you meet specific evaluation criteria below. You should take these into account in any resubmission for a future Gas NIC.

- (a) *accelerates the development of a low carbon energy sector and/or delivers environmental benefits while having the potential to deliver net financial benefits to existing and/or future network customers*

The submission provided weak justification for how the project would deliver environmental benefits or accelerate the development of a low carbon energy sector. It stated that the project would facilitate a development that creates opportunities for others, supporting the Carbon Plan by enabling fuel switching and thus reducing emissions. It did not address the detail of this criterion, with no reference to specific aspects of the Carbon Plan and no comparison with the current most efficient method in GB. The financial benefits were not identified and in any case appear to be dependent on alternative (unspecified) funding being available to support fuel conversion of customers' premises.

- (b) *delivers value for money for gas customers*

The submission provided weak justification for how the project would deliver value for money for gas customers. We understand that the benefits of this project to the gas transportation system would be marginal and that the majority of benefits would only be realised by gas customers on Islay. The proposal did not provide robust justification for the scale of the project. At one sentence in length, the response to the sub-criterion about processes to ensure the project would be delivered at a competitive cost contained insufficient detail.

- (c) *creates knowledge that can be shared across energy networks in Great Britain (GB) or create opportunities for roll-out across a significant proportion of GB networks*

The submission stated that NIC Funding is needed to overcome the commercial risks of this project. There is no evidence to suggest that, were this not the case, such a project would be replicable elsewhere. This means that the learning from the project would be largely redundant without similar support. The explanation of the new knowledge generated is insufficient given the funding request.

- (d) *is innovative (i.e. not business as usual) and has an unproven business case where the innovation risk warrants a limited Development or Demonstration Project to demonstrate its effectiveness*

The submission could have provided much more information on how the knowledge or technology used in this project would be different from existing practices. We do not consider there is enough explanation of how this project is sufficiently innovative with respect to some of the specific requirements set out in the Gas NIC GD.

While we understand that the activities in the project could be innovative and could have the potential to deliver some benefits for gas customers, the submission did not provide enough evidence to demonstrate how the project would meet the Gas NIC ISP evaluation criteria. The Gas NIC GD requires a much tighter focus on what will be demonstrated or developed through the project and you have not shown this in your ISP submission. We also require a higher level of detailed explanation against each of the evaluation criteria, commensurate with the request to use GB gas customers' money.

We hope you take this feedback into account for future submissions to the NIC and would be happy to discuss the criteria with you. We would welcome a further bid from you to the Gas NIC next year in this or a different area.

This letter constitutes notice of the reasons of our decision not to allow The Islay Natural Gas Project to pass ISP and proceed to the Full Submission Process pursuant to section 38A of the Gas Act 1986.

Yours sincerely,



Andrew Burgess

**Associate Partner, Transmission and Distribution Policy**