

**Transmission Workstream
Minutes of Gas Quality Workshop 2
Monday 18 June 2007**

held at

Elexon, 350 Euston Road, London NW1 3AW

Attendees

John Bradley (Chairman)	JB	Joint Office of Gas Transporters
Lorna Dupont (Secretary)	LD	Joint Office of Gas Transporters
Agnes Petersen	AP	Poyry Energy Consulting
Alexandra Campbell	AC	E.ON UK
Andrew Knights	AK	South Hook LNG Terminal
Angela Love	AG	Energy Network Association
Bruce Phillips	BP	Ofgem
Charles Ruffell	CR	RWE npower
Chris Wright	CW	Centrica
Eddie Proffitt	EP	MEUC
Fiona Lewis	FL	BP Gas Marketing
Geert Van Hauwermeiren	GVH	CREG
Jackie Atterton	JA	Px (TGPP) Ltd
Juan Vazquez	JV	Fluxys
Leigh Bolton	LB	Cornwall Energy Associates
Lester Callanan	LC	National Grid NTS
Martin Watson	MW	National Grid NTS
Mike Piggin	MP	TPA Solutions
Nevile Henderson	NH	Gasunie
Ndidi Njoku	NN	Ofgem
Peter Dickinson	PD	Ofgem
Peter Taff	PT	Independent consultant
Raihana Braimah	RB	Ofgem
Richard Street	RS	Statoil
Sean Waring	SW	Interconnector UK
Tim Bradley	TB	National Grid NTS
Tim Davis	TD	Joint Office of Gas Transporters

1 Introduction

JB welcomed all attendees to the meeting and outlined the proposed changes to the agenda that had been previously notified. There were no objections.

2 Review of Minutes and Actions from the previous meeting (23 April 2007)

- 2.1 The Minutes of the previous meeting were accepted.
- 2.2 Updates on outstanding Actions were given as follows:

Action GQ001: Ofgem to ensure that all previous responses were made available on its website.

Update: Completed. *Action agreed closed.*

Action GQ002: MW to consider making a version of the ABB study available to view on a website.

Update: This will be done. *Action carried forward.*

Action GQ003: MW to provide details of Nitrogen Ballasting Plant capacity and how this relates to assumed flows and qualities of high Wobbe gas.

Update: The information was available on Ofgem's website. (If appropriate MW will present any further details at the next Workshop.) *Action agreed closed.*

3 Ofgem Consultation Document – Presentation and Discussion

BP gave the presentation outlining the key issues and Ofgem's initial thoughts on the economic regulation of gas processing services. It was Ofgem's intention to publish the consultation document shortly. He apologised for what might be seen as repetition of items already discussed previously but explained that, following the experience of the last meeting and other industry feedback, Ofgem was now of the view that a more comprehensive assessment of the issues was required, before policy proposals were developed.

The key issues identified were as follows:

- Risk-sharing with consumers
- Competition Impacts
- Upstream issues
- Level of user commitment
- Investment by NGG not backed by user commitment.

3.1 Risk-sharing with consumers

Feedback and submissions had indicated that there were 3 main issues in this area: a high level of uncertainty, cost targeting, and monopoly advantage. Ofgem did not consider that a high degree of uncertainty was sufficient evidence of "market failure". It acknowledged that there was difficulty in targeting service costs to users and thought there may be more efficient ways than socialising costs. Shippers may be able to factor in processing costs and bear a higher risk accordingly. A short discussion on this issue ensued.

CW commented that the funding issue had been discussed at the last meeting and wondered whether there was an option for this element of the cost to be passed back to the consumer. BP observed that feasibility studies should be part of investment costs, and that submissions on this would be welcomed.

LC wondered whether Ofgem had any specific circumstances in mind to support its view of "market failure". RS was unclear as to how "market failure" was being defined; cost differentials could be temporary and inconsistent and should not be seen as justification for investment. Ofgem responded that it viewed "market failure" as where the normal market mechanisms, by themselves, do not provide sufficient incentives for necessary investment. In the circumstances where the market provided sufficient incentives, Ofgem would not need to regulate.

PT thought there should be a distinction between gas entering through an Interconnector and that entering through an LNG terminal, or even from an offshore field. In the latter cases the Shippers involved recognised when their gas did not meet the gas quality specifications and, therefore, accepted the need to install plant such as Nitrogen Balancing. With an Interconnector it was much more difficult to pinpoint the gas that would, in the absence of processing, cause gas quality specifications to be breached. RB agreed these were issues that Ofgem was keen to explore. However, it was not accepted by all that the provision of gas

processing facilities should be funded by the industry as a whole; some attendees viewed it as an interconnector issue.

3.2 Competition Impacts

BP explained Ofgem's views and asked whether its concerns were considered valid.

AK commented that any terminal where a developer had invested to ensure that gas delivered into the system is at the right specification, the developer would feel disadvantaged if any future non-specification gas was then to be processed at a subsidised cost. It would not be seen to be fair to those who had already committed to investing; everyone should have to bear the targeted costs, or alternatively the party causing the problem should pay for the processing. (In AK's view the costs should be targeted and not socialised.) The same models should be consistently applied to all entry points.

RS commented that there was always a cost of entry into a market place. EP observed that quite often gas was processed by producers before entering onshore. Facilities had also been provided where importers of LNG had to pay for processing gas, so why not the same for Interconnectors. RS said that if a premium had to be paid to process gas then the price will feed into the market and agreed with CW that, independent of the funding model applied, gas prices would increase for the consumer. AK responded that, nevertheless, the question still arose: did everyone pay, or only some depending on where the buyer chose to source the gas? SW stated that those who do not require the service do not pay; the question was should the costs be located upstream or downstream? GB customers have a lower Wobbe gas than the rest of Europe, which could be seen as a benefit, and so needs to be paid for. IUK was not in a position to individually identify and target the provider of the non-specification gas, but thought that Fluxys might be. JV observed that Fluxys had no incentive to provide this information, and that gas would remain on the Continent if no one was prepared to pay for changes in specification to be made. If costs were to be allocated based on upstream flows, international co-operation would be required for targeting these costs; if downstream then the consumer pays through a general uplift of prices. It is a commercial decision to choose to flow gas to the UK and the limitations on the specification creates a market opportunity for others to carry out ballasting and deliver gas within specification. Failure to target costs can give opportunities to others who fill the gap to take an unfair commercial advantage.

If the quality of the product cannot be controlled then the risk is that gas may not flow. Some attendees concluded that, and if costs were not socialised, the consumer would pay in winters of stress.

CW asked if the UK would be dependent on out of specification gas within the next few years. AK said there was an oversupply of infrastructure and that the volume of gas would be available, assuming the "correct" gas turned up. CW was concerned that not much time was available to remedy the problem if the UK was facing the prospect of out of specification gas, and dependence on LNG would increase.

MW wondered if there were no processing facilities installed for IUK gas would this concern CREG? If one of CREG's aims was to improve liquidity at the hubs and trade between the hubs had any work been done on this aspect? What would be the impact on the consumer through not having an integrated market? PD commented that the cost of having a similar European standard was significantly greater (billions as against millions) than the cost of organising blending or processing.

GVH remarked that the only parties interested in gas quality were Belgium and the UK, as they were most affected by the problem, which has been identified as a Bacton issue. Each European country had to solve its own problems because of the appliances they used, and each had its own broad criteria. RS commented producers target their markets according to the gas specification of their product, so gas would be priced into the market by product changes and/or price differential.

AK observed that, in the LNG and offshore terminals, producers with "extreme" specification gas pay larger costs as the defaulting parties can be identified. It was acknowledged that IUK cannot control this in the same way as defaulting parties could not be identified. To counteract

this inability the objective must therefore be to push costs upstream as far as possible, as this would then target the defaulting parties where the largest revenues and profits were being made.

NH observed that despite a number of discussions no progress appeared to have been made and a circular argument had developed. If Shippers did nothing and National Grid NTS, nevertheless, decided to invest in processing then costs would be added to National Grid NTS' transportation charges, and the consumer would pay. Shippers needed to recognise the necessity of investing and identify the market opportunities. AL commented that the lifespan of plant does not give much time or opportunity to recover investment costs.

3.3 Upstream Issues

BP described the upstream issues, acknowledging that these were complex and commercial arrangements may be difficult to amend. The CEN mandate will seek to apply uniformity at the earliest around 2012/13. The onus was likely to be on Shippers to achieve some of the amendments and it was questioned how effective the commercial drivers would be in achieving some of these amendments.

In discussion, SW stated that IUK would need agreement to change the specifications, and to change contracts with affected Shippers. Other Shippers would need to be confident that there was no extra risk/cost associated with the change of specification. The specification contracts would need to change at the same time in Belgium and the UK, and it would need to be established how far upstream this would need to happen. Some Shippers may have to be prepared to take on increased risk.

AK pointed out that some parties may not want the IUK specification to change, especially if they had made investment elsewhere. This may prove obstructive to any proposed change. Negotiation was useless if the market interest was not apparent; so many commercial drivers may make this an insoluble problem. It may in effect be cheaper to push for a socialisation of costs.

Both AL and SW thought that any discussion that involved between 18 and 20 parties to invest in ballast plant would not be greatly supported.

MP questioned if the onus was on Fluxys to manage any delivery of LNG to comply with specification – Fluxys was in control whether it delivered to any part of the network. JV was of the opinion that the issue was the UK market's choice, either to rely on one source or to diversify its sources of gas, and thought that the next cold winter would force answers to what would otherwise only be discussion.

The costs associated with European integration were discussed and it was argued that it may be cheaper to change appliances if the cost of gas not flowing to the UK was significant. If the cost of gas not flowing to the UK was thought to be £10 billion then £2 billion for changing appliances does not seem so bad. It was thought that the DTI report on this would be due out this year.

MP raised the issue of safety. The UK had a different specification to that of Europe and harmonising and adapting to the European specification may give rise to a safety issue. A higher Wobbe rate could increase the risk of death caused by poorly performing appliances at the margins of the existing tolerance range. Broadening the range to match Europe might increase this risk. This view was not accepted by all attendees.

Ballasting with nitrogen was thought to be another issue, as this was an energy intensive and unreliable process. FL advised that ballasting with carbon dioxide had been considered in the DTI Phase 2 document, but was not the most efficient way of ballasting.

3.4 Level of user commitment

Having described the issue, BP asked the meeting if the current framework provided for National Grid NTS to invest in processing services and was National Grid best placed to provide this in the best interests of GB consumers.

MW advised that National Grid NTS had no set plans on how to do this. This needed to be worked out, which meant a return to the debate of building the plant and whether an open season was required. The consumers would still be picking up the risk here and if done on a 100% user commitment basis may not fit so well within National Grid NTS. If National Grid NTS was required to have this obligation, feasibility costs would need to be more clearly established, and how the residual risk was to be shared with consumers would need to be agreed. National Grid NTS did not see this as a business opportunity but was not averse if the market decided that it should do this. Principles would need to be clearly agreed with Ofgem and if not based on 100% user commitment, how would this affect other aspects of its licence? National Grid NTS was keen to see how it could facilitate necessary investment but would need to work out a regime in more detail.

EP asked if points could be learned from the LNG experience and scaled up to the Bacton flows to inform commercial decisions. MW acknowledged the value of this, but stated that feasibility and detailed design involved different costs.

BP asked to what degree National Grid NTS was seen as a key party in providing these services, and was this seen as an advantage? SW remarked that National Grid NTS was able to blend as well as ballast. One facility could be built rather than two.

RS reiterated the ownership issues raised at the previous meeting. If 100% user commitment was required then ownership of the facilities by those users would be warranted. If owned by National Grid NTS and the committing party fails - who would pick up the cost of the failure? Underwriting the costs of the assets would also be an issue.

FL pointed out that the option of 50% of costs being funded by user commitment had been discussed in previous discussions but had not been put forward by Ofgem for consultation. BP acknowledged this in terms of initial funding but pointed out that National Grid NTS funding of capacity, additional to that committed by Users, might be worth considering.

PT observed that if nothing was done and the cold winter arrived the debate would go round again.

FL pointed out that no numbers associated with socialisation had been seen from Ofgem as against the cost of no gas flowing, and wanted to know what the cost/benefit might be.

BP responded that Ofgem wanted to avoid price spikes, but there were investment opportunities for Shippers. FL argued that Shippers could not commit if they did not know what sort of gas will be sourced.

EP asked why consumers should be expected to pay for something that was likely never to be used.

RB stated that Ofgem was happy to support facilitation of specification changes if it was decided as an upstream issue, but needed to acquire information to underpin this. FL reiterated that commercial sensitivity needed to be recognised and sharing of information with Ofgem should be done in private.

RS commented that not all users would get the benefit of investment at Bacton even though they paid for it. It was not only about who should pay but also about allocation, etc.

MW thought clarity was needed on where the risks and responsibilities would sit – with the market, or with National Grid NTS to offer a service? Plans could then be made accordingly.

FL commented further that no new issues had arisen from this presentation and she wondered if the community was expected to repeat/comment again on the same points. BP responded that Ofgem had sensed the desire for further consultation on these issues – some will be general, some may be more about what has been done so far. Ofgem was developing this policy so this extra level of consultation was appropriate. MW said that National Grid NTS supported this and welcomed Ofgem's approach to this consultation. A fuller explanation of the issues was required before the imposition of a further licence obligation.

3.5 Investment by NGG not backed by user commitment

MW stated that National Grid NTS had no better information than the Shippers, who were best placed to make decisions on gas quality. AL referred to the earlier discussion on the potential for National Grid to construct plant with capacity greater than that covered by user commitment.

RB responded that if there were insufficient user commitment, in terms of scale, then National Grid NTS could invest and get an agreed rate of return because of the risk involved.

BP summarised the timetable for consultation. No further issues were identified that Ofgem should cover. GVH observed that there was a task force that was starting discussions within the European Directive. A summary report would be produced but the date had yet to be set. Ofgem agreed to keep the meeting informed of further European developments.

Action GQ004: Ofgem to keep JO informed of European developments.

4 Agree Next Steps

It was agreed that a further Workshop will be arranged later in the year (September/October) following consideration of the responses to the consultation and the subsequent publication of Ofgem's Initial Proposals document.

5 Any Other Business

No other business was raised

Action Log: UNC Transmission Gas Quality Workshop 2 (18 June 2007)

Action Ref	Meeting Date(s)	Minute Ref	Action	Owner	Status Update
GQ 001	23/04/07	3	Ofgem to ensure that all previous responses were made available on its website.	Ofgem (RB)	Completed. Closed.
GQ 002	23/04/07	4	MW to consider making a version of the ABB study available to view on a website.	NG NTS (MW)	This will be done. Carried forward.
GQ 003	23/04/07	5	MW to provide details of Nitrogen Ballasting Plant capacity and how this relates to assumed flows and qualities of high Wobbe gas.	NG NTS (MW)	The information was available on Ofgem's website. (If appropriate MW will present any further details at the next Workshop). Closed.
GQ 004	18/06/07		Ofgem to keep JO informed of European developments.	Ofgem (PD/RB/BP)	