GETTING THE DEAL THROUGH

Gas Regulation

in 33 jurisdictions worldwide

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GLOBAL
COMPETITION
REVIEW

United Kingdom

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Description of domestic sector

1 Describe the domestic natural gas sector, including the natural gas production, liquefied natural gas (LNG) storage, pipeline transportation, distribution, commodity sales and trading segments.

At present the UK is the fourth-largest producer of natural gas in the world – the second-largest in Europe after Russia – and produces approximately 3.2 per cent of the total world supply. Gas consumption in the UK has grown by 66 per cent since 1992 and is forecast to increase by a further 11 per cent by 2011. Due to its increasing reliance on natural gas, the UK has become increasingly dependent on imports of gas in order to meet its energy needs. While the UK has a number of producing fields, in the North and Irish Seas, the UK became a net importer of gas in 2004.

Great Britain (England, Scotland and Wales)

Production

The UK obtains its gas from the following main sources:

- domestic production in the North and Irish seas;
- Belgium – the Bacton–Zeebrugge Interconnector (the Belgian Interconnector);
- Netherlands – the Balgzand–Bacton Interconnector (the BBL Interconnector);
- Norway – the Ormen Lange gas field–Easington (the Langeled pipeline);
- Russia – a further pipeline is planned from the Baltic Sea to the UK (the North European Pipeline); and
- shipments of liquefied natural gas (LNG) to the Grain LNG import terminal at Isle of Grain and GasPort LNG at Teesside. Two further import terminals are under construction at Milford Haven – Dragon LNG and South Hook LNG.

Storage

The UK has gas storage facilities. The main one is offshore, in the Rough field. There are also some onshore salt cavity storage facilities in Cheshire, Hatfield and Hornsea. Further onshore facilities have been proposed. Centric has also announced that it is considering investing £300 million in a new offshore facility in the Irish Sea.

Transportation

To provide suppliers with gas, shippers buy capacity on the high-pressure gas pipeline system, the National Transportation System (NTS), owned and run by National Grid Gas plc (NGG). Gas production from the North and Irish Seas is piped ashore to beach terminals, the largest being St Fergus, Teesside and Bacton.

Distribution

Eight regional distribution networks (DNs) own and operate the low-pressure pipeline system and distribute gas from the NTS to end-customers.

National Grid plc (National Grid) owns and operates four of the DNs. The four other DNs (Scotland, the North of England, Wales & the West and the South of England) were sold by Transco in 2005 as part of the reshaping of the gas industry.

There are also several independent gas networks not connected with the NTS or local distribution networks.

Supply

The UK's gas supply market is open to competition, with business and residential customers free to select from which supply company they buy their gas.

Commodity market

There is a sale and trading market. Shippers trade capacity with each other and with NGG, which acts as a central counterparty.

Northern Ireland

Imports

A pipeline from Scotland to Northern Ireland provides the means of establishing a public natural gas supply in Northern Ireland (the Moffat Interconnector). In addition, there is a pipeline from the Republic of Ireland to Northern Ireland (between Dublin and Antrim) which provides additional security of supply.

Transportation

The onshore transportation system, which currently only serves the Greater Belfast area, is operated by Phoenix Natural Gas Ltd, who have been granted an exclusive licence in order to allow them to develop the network.

In addition, Bord Gáis Éireann has two licences for the conveyance and supply of gas in areas within Northern Ireland along the route of the North West and South North pipelines.

Supply

The Northern Ireland Authority for Utility Regulation (NIAUR) is the regulator for the Northern Irish gas supply market. Although this market has not yet been liberalised, the NIAUR has proposed that larger gas customers be able to choose their natural gas supplier within two years and domestic customers a few years after.

Because of the small size of the Northern Irish gas sector, and as it is subject to different regulations and regulators to those covering the rest of the UK, unless otherwise expressly stated, this chapter does not comment further on the regulatory regime in Northern Ireland.

Policy and legal framework

2 What is the statutory framework for the domestic natural gas sector?

The domestic natural gas sector is regulated separately at the upstream (exploration and production) and downstream (transport and supply) levels, as follows:

- the Petroleum Act 1998 (Petroleum Act) and the Pipe-lines Act 1962 (Pipelines Act) govern the installation of offshore pipelines and licences for exploration and production of natural gas;
- the Gas Act 1986 as amended by the Gas Act 1995, the Utilities Act 2000 and the Energy Act 2004 (Gas Act) is the main legislation in the downstream sector. The Gas Act provides for licensing of gas suppliers, gas transporters, gas shippers and operators of international gas interconnectors;
- EC Directive 2003/55 (as amended) (Acceleration Directive) promotes the accelerated liberalisation of the gas and electricity markets in the EU (see the EU chapter for details). It was implemented in the UK by the Gas Act; and
- amendments to the Gas Act were introduced by the Gas (Third Party Access) Regulations 2004 concerning certain procedures for exemption from third-party access requirements.

3 What is the government's policy for the domestic natural gas sector and which bodies set it?

Government policy in the domestic natural gas sector is developed and implemented by the Department for Business, Enterprise and Regulatory Reform (BERR). BERR's focus is to secure UK gas supplies for the medium and longer term. Liberalisation of the EU's gas sector through the Acceleration Directive is key to this supply challenge.

The Office of the Gas and Electricity Markets (Ofgem) supports the Gas and Electricity Markets Authority (GEMA) which is the regulator of the gas and electricity industries in Great Britain. The relevant secretary of state cannot direct the regulator. Ofgem formulates policy initiatives as part of its role to protect and advance the interests of consumers. It is governed by GEMA, and references in this chapter to Ofgem should be understood as referring also to GEMA.

Furthermore, the Gas and Electricity Consumer Council makes proposals about consumer matters.

The government has a tripartite strategy to deal with fluctuating gas prices:

- strive towards greater European liberalisation and competition;
- strive towards UK market improvements, particularly in information flows; and
- encourage Ofgem to use its powers under the Competition Act 1998 (Competition Act) against anti-competitive conduct.

Regulation of natural gas production

4 What percentage of the country's energy needs are met directly or indirectly with natural gas and LNG? What percentages of the country's natural gas needs are met through domestic production and imported production?

Natural gas and LNG constitutes about 33 per cent of the UK's energy consumption, according to BERR's most recent 'Digest of United Kingdom Energy Statistics'. In 2004, 88 per cent of natural gas consumed in the UK was domestically produced and 12 per cent imported, and 11 per cent of domestic production was exported.

5 What is the ownership and organisational structure for production of natural gas (other than LNG)?

Natural gas production is performed under licence by private companies or state-owned companies of other countries. Importing occurs by means of interconnector pipelines pursuant to private contractual arrangements.

6 Describe the regulatory framework and any material governmental or administrative authorisations applicable to natural gas exploration and production.

The exclusive right of exploration, development and production for gas is vested in the Crown. Accordingly, the appropriate form of production licence (PL) must be obtained from BERR for offshore and onshore exploration and production activities. Each licence covers exploration, appraisal and development and production. PLs expire at the end of various phases, unless sufficient progress has been made by the licensee to move to the next phase.

The Energy Act 1976 makes provision for the secretary of state to make emergency orders regulating the production, supply, acquisition or use of gas or its supply price.

Before carrying out exploration and production activities, appropriate non-gas authorisations (such as land access rights) will need to be obtained from the relevant authorities and property owners.

7 How does the government derive value from natural gas production?

As well as deriving value from rentals and royalty income from PLs, the government levies corporation tax on profits from gas production in the UK and this is supplemented by a North Sea tax regime.

Regulation of natural gas pipeline transportation and storage

8 What is the ownership and organisational structure for pipeline transportation and storage of natural gas?

Transportation

Transportation and storage of natural gas are still performed mainly by NGG, a privately-owned regulated utility that operates the high-pressure NTS.

The NTS supplies gas to the UK's gas powered power stations, a small number of large industrial consumers and the 12 local distribution zones (LDZs) that contain pipes operating at lower pressure, which eventually supply other consumers.

The 12 LDZs are managed within eight DNs. Following the sale by National Grid of four DNs, the owners of the DNs are now as follows:

- North West, London, West Midlands and East of England (East Midlands LDZ and East Anglia LDZ) – owned and managed by National Grid;
- Scotland and South of England (South LDZ and South East LDZ) – owned and managed by Scotia Gas Networks plc (operating as Scotland Gas Networks and Southern Gas Networks respectively);
- Wales and the West (Wales LDZ and South West LDZ) – owned and managed by Wales and West Utilities Ltd; and
- North of England (North LDZ and Yorkshire LDZ) – owned by Northern Gas Networks Ltd.

Storage

Gas is stored in LNG facilities, in salt cavities and in depleted onshore and offshore gas fields. LNG storage sites are operated by

a ring-fenced business within NGG (LNG Storage) and are operationally separate from NGG's transportation role. There are currently four storage facilities owned and operated by LNG Storage in Bristol, South Wales, Manchester and Strathclyde (see question 1).

9 Describe the regulatory framework and any material governmental or administrative authorisations applicable to the construction, ownership and operation of natural gas transportation pipelines and storage facilities.

The principal authorisation for transportation is a transporter's licence issued under the Gas Act. The transporter is required to establish transportation arrangements that achieve efficient and economic operation of the pipelines, efficient discharge of its licence obligations and effective competition between relevant shippers and suppliers.

The Petroleum Act governs the installation of offshore pipelines. Any person constructing a pipeline in, under or over any UK waters must obtain an authorisation from the secretary of state. Such activities are to be carried out in compliance with the applicable PL. The field development programme approved by BERR will also regulate the construction and operation of offshore pipelines.

The Crown Estate Act 1961 requires a licence from, and the payment of a consideration to, the Crown Estate Commissioners for the development of an offshore gas storage facility.

The Offshore Installations and Wells (Design and Construction, etc) Regulations 1996 state that offshore gas facilities must be designed, constructed and kept in sound structural state.

Under the Pipelines Act the construction of pipelines over 10 miles in length requires a 'pipeline construction authorisation' from the secretary of state. That authorisation may include authorisation under the relevant planning laws (such authorisations always apply to shorter pipelines).

Under the Gas Act 1965, a transporter may obtain a 'storage authorisation order' authorising onshore underground storage in accordance with the terms of the order, which grants deemed planning permission. In addition, storage over certain volumes may need to be approved by the relevant local authority. Alternatively, a transporter or someone other than a transporter could directly apply for planning permission without reference to a 'storage authorisation order'. However, other statutory requirements will apply (principally hazardous substances consent, integrated pollution control and health and safety executive regulations).

Attention will also need to be given to relevant UK legislation, mostly environmental and health-and-safety related.

Under the Acceleration Directive, any authorisations relating to transportation or storage granted pursuant to the Gas Act or the Pipelines Act are subject to minimum transparency and non-discrimination requirements. The Acceleration Directive also requires that refusals to grant such authorisations be reasoned and subject to appeal before an independent judicial body (see the EU chapter).

Should any other appeal procedure not result in the desired decision, a decision made by BERR, Ofgem or the secretary of state can be subject to judicial review should there be appropriate grounds for such an appeal.

For example, under the Gas Act, Ofgem must give notice of its reasons for a decision to the licence-holder to whom the decision relates, and it must allow time for, and consider, representations. Although the Gas Act provides for an appeals procedure where Ofgem has imposed a penalty, it does not provide for a specific procedure for appealing licence decisions, although they would be subject to judicial review.

10 How does a company obtain the land rights to construct a natural gas transportation or storage facility?

As part of the transportation and storage authorisation process under the Gas Act and Pipelines Act, the secretary of state has the power to issue orders for the compulsory purchase of land in order to construct a gas transportation or storage facility. In the absence of such orders, the constructor will be required to purchase any necessary rights directly from landowners and other rights owners.

11 How is access to the natural gas transportation system and storage facilities organised?

Downstream transportation and storage infrastructure

The Acceleration Directive mandates non-discriminatory third-party access (TPA) to transportation and distribution facilities. Under EU law, TPA to storage facilities must be provided on the basis of regulated or negotiated access (see EU chapter).

The Gas Act requires every transporter to comply with any reasonable request for it to convey gas via its pipeline system to any premises, to the extent this does not prejudice the transporter's ability to develop and maintain an efficient and economical pipeline system.

The TPA regime for onshore transmission and distribution networks and international interconnectors is implemented through the licensing regimes applicable to transporters and interconnector operators and requires that non-discriminatory terms of access be published and pricing methodologies be approved in advance with Ofgem.

The TPA regime for gas and LNG storage facilities is governed by the Gas Act, and allows for negotiated access. The storage operator must publish non-discriminatory commercial terms for TPA and negotiate in good faith with parties seeking access, subject to the right of Ofgem to require access if negotiations fail.

Exemptions granted by Ofgem from the TPA obligations are available under the Gas Act for storage facilities and are governed by the interconnector licensing regime for interconnector operators.

The Uniform Network Code (UNC) is the hub around which the competitive gas industry revolves, comprising a regulatory and contractual framework to supply and transport gas. It has a common set of rules for all industry players that ensures a level playing field for competition. The UNC also stipulates conditions in relation to gas quality, pressure and odour.

The UNC is managed by the Joint Office of Gas Transporters and contains detailed arrangements for delivery to, off-take from and balancing of the NTS.

The principles underlying the UNC are that:

- gas transportation services should achieve market requirements;
- system security and safety should be assured;
- pricing should reflect the actual costs of the services concerned;
- robust computer systems should be developed and maintained;
- daily energy balancing should be operated; and
- gas shippers should be encouraged to balance their own supply and demand.

The UNC is supplemented by a series of individual network codes (one for each of NGG and the four other DN operators), which set out the terms of the transportation arrangements that are common to these operators by reference to the UNC, without setting out any substantive provisions.

For later signatories, an accession agreement with the same substantive effect is entered into to become a party to the UNC.

As well as the UNC itself, any party wishing to become a shipper must sign an ancillary agreement with NGG or the relevant DN operator (or both) that sets out arrangements that are specific to that shipper or its chosen entry or exit points. As a result, those details are not explicitly set out in the UNC.

Capacity auctions

The UNC provides for both firm and interruptible system entry capacity auctions.

Firm entry capacity is offered in bundles of quarters, months and days. Interruptible capacity is only offered on a daily basis. Subject to reserve prices, shippers who are successful in the auction pay their bid price.

For quarterly or monthly system entry capacity, unsold capacity may be purchased from NGG at prices based on those in the auction on a 'first come, first served' basis.

There is a reverse auction process to allow NGG to buy back capacity.

Balancing

Shippers are incentivised to balance their deliveries and offtakes from the NTS on a daily basis by the levying of daily imbalance charges.

Storage

NGG maintains storage capacity and stored gas for operational balancing purposes. For existing LNG storage facilities, LNG Storage's charging methodology establishes prices at each of its current LNG facilities that reflect the differing costs of providing storage services from different facilities.

Upstream transportation and storage infrastructure

Prices and terms of access to upstream pipelines and upstream storage are not directly regulated. In the event of a TPA dispute, under the Gas Act and the Pipelines Act the party may apply to the secretary of state (or, in the case of storage, Ofgem) to resolve the dispute. Further details are in the non-statutory BERR Code of Practice on Access to Upstream Oil and Gas Infrastructure.

12 To what degree are pipeline systems interconnected with one another and by what means is cooperation between such systems established?

The system of cooperation between NGG and the other DN operators is described briefly in questions 11 and 19. There are three operational interconnectors between the NTS and systems outside the UK: the Moffat Interconnector; the Belgian Interconnector; and the BBL Interconnector. The functioning of these interconnector systems varies. An interface between interconnector system participants is established through private contracts.

Connections to the NTS itself are only considered for loads consuming in excess of 58.6 million kWh per year (2 million therms per year).

13 Can customers, other natural gas suppliers or an authority require a pipeline or storage facilities operator to expand its facilities to accommodate new customers? If so, who bears the costs of interconnection or expansion?

For downstream pipelines operated by a gas transporter, an application can be made to Ofgem under the Gas Act for:

- an increase in capacity of a downstream pipeline system, through modification of associated works and apparatus; and
- the installation into any downstream pipeline system of a junction for connection of another pipeline.

Any resulting order to carry out such modifications will be subject to payment by the applicant of reasonable remuneration, as determined by Ofgem according to criteria set out in the legislation.

For upstream pipelines, a similar application may be made under the Petroleum Act. The applicant will be obliged to pay to the pipeline owner such reasonable remuneration as is determined by the secretary of state.

When required to do so by an owner or occupier, a transporter must, under the Gas Act:

- transport gas to any premises within a certain distance of a distribution main or a service pipe connected to any such main; and
- in the former case, the transporter must also provide and lay any pipe necessary for that purpose.

Furthermore, NGG's gas transporter licence creates incentives for NGG to upgrade its transportation facilities to accommodate increased demand.

There are no equivalent obligations for gas storage operators to modify their infrastructure at the request of a customer, supplier or authority. To the extent that a storage operator opts to undertake a major increase in capacity, it can apply for an exemption from the requirement to grant TPA to the incremental capacity (see question 11).

14 Describe any regulation of the prices or terms of service for pipeline or storage services.

Ofgem controls NGG's pricing methodologies, services and performance standards through various obligations imposed in its gas transporter licences.

Transportation and distribution activities are separately licensed, with separate pricing methodologies applicable to each.

All of Britain's transportation and gas distribution network companies have accepted the price controls proposed by energy regulator Ofgem. The proposals, which came into effect on 1 April 2007 for transportation activities and 1 April 2008 for distribution activities, will apply for five years from each of those dates for the transportation companies and the gas distribution companies (respectively).

See questions 11 and 20 for further information on the regulation of terms and conditions for access to pipeline and storage services.

15 Describe any statutory and regulatory requirements applicable to the processing of natural gas to extract liquids and to prepare it for pipeline transportation.

The processing of natural gas purely to remove natural gas liquids does not require either a licence or consent. The liquefaction of offshore natural gas is governed by the Energy Act 1976 (as amended). The legislation provides that the consent of the secretary of state is required for offshore natural gas to be liquefied in the UK (with limited exceptions). Under the Gas Act 1995, access to upstream gas processing facilities is subject to a dispute resolution procedure similar to that applicable to other upstream infrastructure (see question 11).

16 Describe the contractual regime for transportation and storage.

The transportation and storage of gas is governed by the provisions of the relevant transporter's licence, the terms of which are determined by Ofgem, and by the contractual nexus surrounding the UNC. For further details, see questions 9, 11 and 18.

Regulation of natural gas distribution

17 What is the ownership and organisational structure for the local distribution of natural gas?

NGG operates four of the eight DNs for National Grid: North West, London, West Midlands and East of England (East Midlands LDZ and East Anglia LDZ). The remaining four DNs are owned and managed as follows:

- Scotland and South of England (South LDZ and South East LDZ) by Scotia Gas Networks plc (operating as Scotland Gas Networks and Southern Gas Networks respectively).
- Wales and the West (Wales LDZ and South West LDZ) by Wales and West Utilities Ltd; and
- North of England (North LDZ and Yorkshire LDZ) by Northern Gas Networks Ltd (who have contracted operational activities to United Utilities Operations Ltd).

18 Describe the regulatory structure and governmental or administrative authorisations required to operate a distribution network. To what extent are gas distribution utilities subject to public service obligations?

The operator of a distribution network is required to have a transporter's licence (see question 2).

NGG's transporter's licence currently imposes public service obligations in respect of the provision of metering services (for example there is an obligation to act as a provider of last resort of meter services), services for customers that are old, infirm or disabled and certain obligations to connect customers (see question 13).

These public services obligations have also been imposed on the operators of the four DNs sold by NGG under their transporter's licences.

19 How is access to the natural gas distribution grid organised?

The current arrangements for access to the transportation system (comprising both the NTS and the DNs) are described in question 11. The NTS serves the four DNs retained by NGG as well as the four other DNs. To reduce unnecessary complexity and prevent fragmentation, a central agency (xoserve) was created to administer the processes needed to support gas competition and the collection of transportation bills on behalf of all DN owners and the NTS. Shippers who bring gas onto the pipeline network deal with xoserve instead of the DN owners. The Joint Office of Gas Transporters administers modifications, on an impartial basis, to the UNC (see question 11).

20 Describe any regulation of the prices for distribution services. In which circumstances can a rate or term of service be changed?

Transportation charges are subject to price control formulae set by Ofgem as set out in each gas transporter's licence. They dictate the maximum revenue a transporter can earn for each unit of gas transported through its network, for instance:

- should a transporter not earn the maximum permitted revenue in a formula year, a compensating adjustment is made in the following year; and
- where a significant over-recovery is anticipated within a year, charges may be adjusted during the year.

NGG uses the activity-based costing method to analyse its costs and the charges it passes on to its customers for the transportation services it provides.

As explained in question 14, pricing of transportation and distribution-related services are separate.

21 May the regulator require a distributor to expand its system to accommodate new customers? May the regulator require the distributor to limit service to existing customers so that new customers can be served?

See question 13. Also, under the Gas Act, gas transporters (including distributors) have a duty to develop and maintain an efficient and economical system of gas supply. Subject to this requirement, each transporter also has a duty to comply with any reasonable request for it to connect to any premises and avoid any undue preference in the supply of gas to persons entitled to a supply.

22 Describe the contractual regime in relation to natural gas distribution.

A company with a supplier's licence contracts with gas shippers to buy gas which it then sells to business and residential consumers. For the supplier to transport the gas to the consumer, xoserve (see question 19) provides administrative services on behalf of each of the DN operators to the gas shipper. Each of the transactions between the shippers and the transporters is subject to the UNC and any relevant individual DN operator's network code and ancillary agreement (see question 11). The price that can be charged by a DN operator is governed by the terms of its transporter's licence and is subject to Ofgem's supervision (see question 14). Consumers are able to contract with any supplier in order to seek the best price.

Regulation of natural gas sales and trading

23 What is the ownership and organisational structure for the supply and trading of natural gas?

The trading arrangements have:

- an anonymous within-day gas market - the on-the-day commodity market (OCM);
- price auctions of NTS capacity related to the physical capacity available;
- incentives on NGG relating to the capacity regime and its role as residual system balancer; and
- incentives on shippers to balance their positions.

The OCM is operated by an independent market operator (EnMO) and is designed for gas trading in which the shipper and NGG can post bids and offers to buy or sell gas either at the national balancing point or at specific locations on the NTS. EnMO also operates the EnEx trading platform and the Gas Physical Futures market, which allows physical gas contracts to be traded, before delivery, alongside the OCM. EnMO has also introduced weekend, balance of week and working days next week strips to allow traders to trade gas further ahead of physical delivery.

24 To what extent are natural gas supply and trading activities subject to governmental oversight?

Natural gas supply activities are regulated by Ofgem, whose role is to protect and advance the interests of consumers by promoting

competition where possible and using regulation where necessary to achieve that end. Gas supply is a licensed activity under the Gas Act.

Ofgem can impose financial penalties of up to 10 per cent of the licensed supplier's turnover in the event of breach of licence conditions. In addition to regulation under the licence system, Ofgem has powers to enforce a wide range of UK consumer protection laws.

To the extent that gas traders do not supply gas to final consumers, they do not need a licence from Ofgem. However, they are regulated by the Financial Services Authority under legislation such as the Financial Services and Markets Act 2000.

25 How are physical and financial trades of natural gas typically completed?

The European Federation of Energy Traders (EFET) publishes standardised general agreements (EFET agreements) for the delivery and acceptance of gas. Where EFET agreements have been negotiated, gas trades can be completed using short-form confirmations. EFET agreements allow the counterparties to choose a range of contractual provisions to govern their relationship (including such matters as automatic and early termination, insolvency, payment netting and credit support). The short form confirmations then need only state the basic pricing and quantitive information agreed for an individual deal. A legal opinion can be purchased from EFET, which addresses the enforceability of the EFET elective provisions under UK law.

26 Must wholesale and retail buyers of natural gas purchase a bundled product from a single provider? If not, describe the range of services and products that customers can procure from competing providers.

There is no such obligation. Wholesale customers can purchase gas as a wholesale commodity from competing providers and obtain entry and exit capacity on the NTS and related balancing services (see question 19).

Gas nominations

By a certain time each day, a shipper must inform NGG how much gas it wishes to transport on the following day.

Capacity trading

Shippers may offer spare capacity for sale so shippers requiring capacity can view what is on offer and make bids for it. The seller chooses which bid to accept and NGG effects the transfer of entitlement.

Industrial and residential customers are able to buy gas from any supplier who is licensed to supply gas within that customer's distribution area.

Regulation of liquefied natural gas (LNG)

27 What is the ownership and organisational structure for LNG, including liquefaction and export facilities and receiving and regasification facilities?

There are no LNG liquefaction or export facilities. There are currently two LNG import terminals. One at the Isle of Grain into which LNG is imported (principally from Qatar) under a 20-year contract between National Grid (which operates the terminal) and BP/Sonatrach (the shipper). The other GasPort LNG at Teesside developed by Excelerate Energy LLC. Two further LNG import terminals are under construction and are expected to be commissioned by next summer:

- Dragon LNG at Milford Haven – capacity up to 6 billion cubic metres (Bcm) (with the possibility of an additional 6Bcm in later expansion); owned and operated by Dragon LNG (a joint venture between BG Group plc, Petroliam Nasional Berhad (Petronas) and 4Gas BV); and
- South Hook LNG at Milford Haven – capacity up to 20Bcm; owned and operated by South Hook LNG Terminal Company Ltd (a joint venture between Qatar Petroleum LNG Services (QG II) Ltd, ExxonMobil Qatargas (II) Terminal Company Ltd and Elf Petroleum UK Ltd).

The following additional facilities are all in the initial stages of development:

- a facility on Canvey Island (being developed by Calor Gas Ltd, LNG Japan Corporation and Osaka Gas);
- a facility on the Isle of Anglesey (being developed by Canatxx Energy Venture Inc);
- the offshore Irish Sea Gateway project (proposed by Star Energy Group plc); and
- the Norsea LNG terminal in Teesside (proposed by ConocoPhillips Petroleum Company UK Ltd).

28 Describe the regulatory framework and any material governmental or administrative authorisations required to build and operate LNG facilities.

There are no specific authorisations for the construction of LNG facilities, but they will need to comply with the environmental, planning and health and safety requirements discussed at question 9. However, operators of LNG import facilities are exempt from the requirement to obtain a gas transporter's licence for their conveyances of gas into the NTS.

29 Describe any regulation of the prices and terms of service in the LNG sector.

LNG import facilities are subject to a mandatory regulated TPA regime under the Gas Act, for example non-discriminatory terms of access must be published and pricing methodologies must be approved in advance by Ofgem (see question 11). However, exemptions are available when certain conditions are met, for example promotion of security of supply and absence of detriment to competition.

Mergers and competition

30 Which governmental body may prevent or punish anti-competitive or manipulative practices in the natural gas sector?

Ofgem has concurrent powers with the Office of Fair Trading (OFT) to prevent and prosecute anti-competitive practices in the natural gas sector under the Competition Act and the Enterprise Act 2002 (Enterprise Act) (see the Competition Act 1998 (Concurrency) Regulations 2004 and OFT Guidelines 405 and 428).

Ofgem also has powers to prevent and prosecute anti-competitive practices under the Gas Act. The NIAUR in Northern Ireland has similar powers.

31 What substantive standards does that governmental body apply to determine whether conduct is anti-competitive or manipulative?

Competition Act

The chapter I and II prohibitions of the Competition Act, which are based on the provisions of articles 81 and 82 of the EC Treaty, are applied to determine whether conduct is anti-competitive.

For example, GEMA fined National Grid £41.6 million in February 2008 in relation to Ofgem's investigation into abuse of dominance in the provision of domestic gas meters in breach of chapter I. National Grid has appealed that fine to the Competition Appeal Tribunal (CAT) under the Competition Act.

Enterprise Act

Under the Enterprise Act, Ofgem and the OFT have concurrent powers to make a reference to the Competition Commission where, in the absence of any obvious breach of the Competition Act or articles 81 or 82 of the EC Treaty, they have reasonable grounds for suspecting that competition has been prevented, restricted or distorted by any feature of a market in the UK relating to commercial activities connected with the exploration for or production, transportation or supply of gas.

The Enterprise Act also introduced criminal sanctions for certain significant breaches of competition law, such as agreements between competitors to fix prices or to allocate markets, involving an element of dishonesty.

Gas Act

Participants' behaviour in gas markets is also regulated by the Gas Act and the conditions in the licences granted under that legislation. The Gas Act and the related licences regulate and attempt to prevent various types of anti-competitive behaviour that may have detrimental effects on customers. However, Ofgem may not take enforcement action under the Gas Act if it is satisfied that it would be more appropriate to address the issue under the Competition Act.

32 What authority does the governmental body have to preclude or remedy anti-competitive or manipulative practices?

The Competition Act gives the OFT and sector regulators, including GEMA, powers to apply and enforce articles 81 and 82 of the EC Treaty as well as the chapter I and II prohibitions of the Competition Act, using their concurrent powers. See the OFT's competition law guideline titled 'Application in the Energy Sector'.

Under the Competition Act, Ofgem or the OFT (or both) may declare an agreement anti-competitive and null and void and impose fines of up to 10 per cent of worldwide turnover on undertakings which infringe the Competition Act. Decisions under the Competition Act of the OFT or Ofgem (or both) can be appealed to the CAT.

Under the Enterprise Act, where the Competition Commission has decided that there is an adverse effect on competition in relation to the market it has investigated, it has the power to take action to remedy, mitigate or prevent the adverse effect concerned.

Ofgem also monitors the licensing regime and may enforce compliance with the licences and statutory provisions. In addition, under the Gas Act, Ofgem may impose fines of up to 10 per cent of the turnover of the licence holder for breach of any relevant condition or requirement, or failure to achieve any standard of performance prescribed by law.

Where infringements of more than one provision are under consideration, Ofgem will determine the most appropriate power to remedy the anti-competitive behaviour identified.

33 Does any government body have authority to approve or disapprove mergers or other changes in control over businesses in the sector or acquisition of production, transportation or distribution assets?

Mergers, changes in control and asset acquisitions in the gas sector, like any other sector, may fall to be investigated by the EU or UK merger control authorities.

OFT

If the transaction is not caught by the EC Merger Regulation 2004, it will qualify for investigation by the OFT under the Enterprise Act, if either:

- the target has a turnover exceeding £70 million in the UK; or
- the acquisition creates or enhances a share of supply of at least 25 per cent of goods or services of a particular description, either in the UK as a whole or in a substantial part (a region or county could be a substantial part).

Under the Enterprise Act, the OFT must (subject to certain limited exceptions) refer an acquisition for a detailed investigation by the Competition Commission if it believes the transaction may result in a 'substantial lessening of competition' within any market in the UK. The OFT may alternatively seek undertakings from the relevant parties to remedy the adverse effects and avoid referral.

The OFT consults Ofgem where relevant and considers Ofgem's views on the competition aspects of a transaction.

Competition Commission

Following a referral, the Competition Commission carries out a detailed investigation in order to determine whether a merger has resulted or may result in a substantial lessening of competition. If competition problems are identified, the Competition Commission is required to take action that it considers to be reasonable and practicable to remedy, mitigate or prevent the competition problems that it has identified. This action may range from prohibiting the merger or requiring divestments of business, to a variety of behavioural undertakings.

Timing

The timetable for dealing with mergers varies according to whether the merging parties submit a completed merger notice to the OFT on announcement of the transaction or make an informal submission. Under the Enterprise Act:

- if the parties submit a completed merger notice to the OFT, the OFT must decide whether or not to refer within a period of 20 working days (extendible by 10 working days);
- if the parties file an informal submission, the OFT is not bound by a statutory timetable in which to refer to the Competition Commission, but the OFT will aim to take a decision within 40 working days; and
- following a referral for investigation, the Competition Commission must reach its decision and publish its report within 24 weeks, with an extension of up to eight weeks.

34 In the purchase of a regulated gas utility, are there any restrictions on the inclusion of the purchase cost in the price of services?

While no restrictions on the inclusion of the purchase cost in the price of services are specifically set out, it is unlikely that Ofgem would allow price increases to cover the purchase cost. Instead, the purchaser would be expected to cover the purchase cost via cost savings and efficiency gains. The components of the service charge calculation for transportation are outlined in question 20.

Update and trends

With demand for gas in the UK expected to continue to increase in the coming years, Ofgem announced in March 2008 that it is to open a two-year review of the regime governing the regulation of the gas network. That review will examine whether the current regulatory approach can continue to deliver a reliable and well-run gas network with good service at reasonable prices (amid growing concern regarding the investment challenges faced by the gas network with particular regard to growth in gas imports). The current regulatory regime pegs increases in network charges and expenditure allowed by network operators below the retail prices index (RPI). That RPI-X arrangement is likely to be a main area of consideration. The review will report in 2010.

As at April 2008, BERR is looking to reform the regulatory framework for both onshore and offshore gas infrastructure. Further to the Energy Bill, which is currently in the committee stage of the parliamentary process, a Planning Bill, which proposes a more streamlined and transparent planning system for nationally significant infrastructure, including gas infrastructure, is also in the committee stage. Both bills are intended to reduce the uncertainty surrounding planning applications for gas infrastructure projects, which can act as a disincentive for investment.

In May 2007, BERR launched a consultation on 'guidance' it would issue in relation to the storage of gas in natural porous strata onshore. That consultation process has now closed. The government's response is due to be released in the near future.

BERR published the first comprehensive 'Energy Markets Outlook' document in October 2007. It gives detailed information on energy issues and sets out projections covering energy markets. Chapter 5 of that document is dedicated to the UK gas market.

35 Are there any restrictions on the acquisition of shares in gas utilities? Do any corporate governance regulations or rules regarding the transfer of assets apply to gas utilities?

Acquisitions of the requisite level of control may qualify for review by UK or EU merger control authorities and relevant industry regulators. Otherwise, there are no restrictions on the acquisition of shares in gas utilities, provided that the acquisition will not result in the same corporate entity holding both a transportation or interconnector licence and a supplier's or shipper's licence (see question 2).

International

36 Are there any special requirements or limitations on foreign companies acquiring interests in the natural gas sector?

No.

37 To what extent is regulatory policy affected by treaties or other multinational agreements?

All UK regulation is constrained by the requirements of EU law. These requirements relate to both competition in general and sector-specific concerns (see the EU chapter). The UK is also a member of the energy charter conference, and has ratified the Energy Charter Treaty and associated protocols.

38 What rules apply to cross-border sales or deliveries of natural gas?

The operation of an interconnector is a licensed activity. Ofgem is in charge of issuing licences to all new interconnectors. Also, new contractual arrangements have been developed for the Moffat Interconnector and the Belgian Interconnector, specifically to deal with the interface with the NTS. The UNC and interconnector transportation agreements, as well as the arrangements mentioned below, have been entered into to regulate arrangements at the connection point.

The Belgian Interconnector is both an exit point and entry point. An interconnection agreement between NGG and Interconnector (UK) Ltd (the interconnector operator) deals with operational procedures, while a Connected System Exit Point (CSEP) Ancillary Agreement governs offtake of gas from the NTS for delivery into the interconnector. In addition, the Bacton Principals Agreement and Bacton Agency Agreement govern the appointment of an agent for the purpose of performing certain tasks relating to shippers' gas flowing in the NTS.

The Moffat Interconnector is only an exit point. Operational issues are covered in the Connected Systems Agreement and the Pressure Maintenance Agreement between NGG and BGE (UK) Ltd (the operator of the Moffat Interconnector). Other relevant agreements are the CSEP Ancillary Agreement, the Moffat Administration Agreement and the OPN Agency Agreement, which are similar to those applicable to the Belgian Interconnector.

Transactions between affiliates

39 What restrictions exist on transactions between a natural gas utility and its affiliates?

The primary restrictions concern licensed entities and work to prevent them from transferring their business to a non-regulated affiliate, without the authorisation of Ofgem. In addition, gas transporters are subject to various licensing conditions that seek to prevent them from providing services on terms that discriminate in favour of affiliated companies. Gas suppliers and gas shippers may also have affiliate restrictions in their respective licences.

Discrimination by a dominant company in favour of an affiliate (for example by awarding it an engineering contract on preferential terms) could also be an abuse of its dominant position, contrary to chapter II of the Competition Act. It may also be a breach of rules on public procurement that set down requirements for a fair tender process. Gas transporters will often have a dominant position in the supply of the relevant transportation services in a given area, while shippers or suppliers of gas rarely have dominant positions in practice.

As regards storage, Ofgem has made clear that it will intervene to ensure that storage cannot be purchased by a company and reserved exclusively for the purchaser and its affiliates. In this context, the acquisition by Centrica of Dynegy's Rough gas storage facility in November 2002 was investigated by the Competition Commission. As a result, Centrica made an undertaking in January 2004 to respect various behavioural obligations.

40 Who enforces the affiliate restrictions and what are the sanctions for non-compliance?

For conditions contained in a licence, the relevant authority will be Ofgem. The sanctions, which broadly speaking all stem from the Gas Act, range from requiring a gas utility to provide information – for the relevant authority to substantiate whether there has been an infraction – to fines. For enforcement of general competition law, see questions 31 and 32.

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