Validation Impact Assessment

Title: Onshore Licence Exemption **IA No:** (Triage No - RPC13-FT-DECC-1693) **Lead department or agency:** Department of Energy and Climate Change **Other departments or agencies:** n/a	Impact Assessment (IA)
	Date: 16/05/13
	Stage: Validation
	Source of intervention: Domestic
	Type of measure: Secondary Legislation
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Summary: Intervention and Options	**RPC Opinion:** Triage Approved

Cost of Preferred (or more likely) Option				
Total Net Present Value	**Business Net Present Value**	**Net cost to business per year**	**In scope of One-In, One-Out?**	**Measure qualifies as**
£0.36m	£0.36m	-£0.04m	Yes	Deregulatory

What is the problem under consideration? Why is government intervention necessary?

Section 5(1)(a) of the Gas Act 1986 specifies that a transporter licence is needed for the conveyance of gas through pipes to any premises or pipe-line systems operated by a gas transporter (i.e. gas network companies). Therefore, onshore producers of gas (e.g. conventional, shale, coal-bed methane and biomethane) are currently required to hold a transporter licence if they want to operate pipe work that connects their onshore production facility to the grid. This has been identified by the industry's Energy Market Issues for Biomethane (EMIB) group as a barrier for biomethane sites who wish to inject to the grid. We have assessed that this regulatory problem extends to other forms of gas that can be produced onshore.

Before a transporter licence can be issued by Ofgem, the company must submit in depth information on their commercial arrangements, and detailed information on how they expect to comply with the license conditions, to verify their credibility. On balance we think that this requirement is a disproportionate regulatory burden because onshore producers of gas:

- are not operating pipes that supply gas to consumers directly, therefore are not responsible for consumer security of supply;
- are providing additional grid balancing opportunities to shippers at volumes that could be easily replaced by other sources should the production facility experience a technical failure;
- will still be subject to third party access rules that prohibit anti-competitive behaviour at the network entry facility;
- will sign a Network Entry Agreement (NEA) with the licensed transporter that the facility will connect to that will specify the characteristics that the gas must meet to comply with safety and charging rules.

What are the policy objectives and the intended effects?

We propose to remove the requirement to hold a transporter licence for the length of pipe that conveys gas from the onshore production facility to the gas grid (National Transmission System or Gas Distribution Network) by introducing a class exemption to cover all forms of onshore gas production. The removal of this barrier should, by reducing the costs and administrative burden of entering the market, encourage the diversification of onshore gas supply and assist the growth of the UK onshore conventional and unconventional gas market.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

1. Create a class exemption that applies to all onshore gas producers, which would remove the need and cost (for both industry and government) to draft and approve specific named exemptions under the existing regime, or (where the producer is not already a licensed shipper or supplier) would remove the need and cost for the producer to obtain a transporter licence. This is the preferred option, further details of which are outlined in the evidence base.

2. Encourage onshore gas producers that already hold shipper or supplier licences to restructure their business or subcontract the operation of their pipes to a third party (such as a GDN) who are legally able to hold a transporter licence.
3. Encourage onshore gas producers not to inject gas to grid but instead use it for electricity generation, CHP or commercial/industrial processes.

This validation Impact Assessment focuses only on the preferred option (option 1).

Will the policy be reviewed? No **If applicable, set review date:** n/a

Does implementation go beyond minimum EU requirements? n/a					
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.	Micro 15-61	< 20	Small	Medium	Large
What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)			**Traded:** n/a		**Non-traded:** n/a

I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) that the benefits justify the costs.

Signed by the responsible SELECT SIGNATORY: Neil Bush **Date:** 16/05/2013

Summary: Analysis & Evidence

Description: Transporter licence exemption for onshore gas production

FULL ECONOMIC ASSESSMENT

Price Base Year 2009	PV Base Year 2010	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: 0.16	High: 0.67	Best Estimate: 0.36

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	**0**		**0**	0
High	**0**		**0**	0
Best Estimate	**0**		**0**	0

Description and scale of key monetised costs by 'main affected groups'

n/a

Other key non-monetised costs by 'main affected groups'

There will be no detrimental effects on competition, due to the Third Party Access legislation which acts as a mitigating safeguard - requiring infrastructure operators to provide open and non-discriminatory to third parties who do not own, but wish to use the infrastructure.

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	**0**		**0.02**	0.2
High	**0**		**0.07**	0.7
Best Estimate	**0**		**0.04**	0.4

Description and scale of key monetised benefits by 'main affected groups'

The regulatory change will affect companies wishing to connect to the National Transmission System (NTS) or a Gas Distribution Network (GDN). Exemption from the need to obtain a transporter licence will primarily involve reduced administration costs. Previous analysis carried out for a similar regulatory impact assessment on Gas Licence Exemptions[1] indicates that the administrative cost associated with application for a transporter licence is of the order of £20,000 (in 2010 prices) which reflects the regulatory, legal, commercial and other inputs required in making the application. At the time, DECC judged that this is likely to reflect an upper limit on the grounds that efficiencies might be found in the application process. DECC's 2011 assessment took the view that the lower end of the range could be the cost of the application itself[2]. This gives a range of £1,000-£20,000 in 2009 prices. This assumption is used as the basis of the admin cost to business for this assessment. In addition to this internal administrative cost for companies, there is also a cost to Ofgem in processing applications. These were assumed to be covered by the application fee of £1,016 (in 2009 prices)[3] which, taken with the administration fee gives a total benefit in the range £2,000-£ 21,000 per company with a central case of £12,000 in 2009 prices.

The following types of businesses could potentially be affected by the regulatory change

- existing and future onshore conventional gas producers
- future unconventional gas producers
- biomethane producers

Estimation of the number of companies affected in each case is difficult due to the high degree of uncertainty surrounding the future levels of UK onshore gas production, particularly with respect to unconventional gas and biomethane. It is therefore necessary to base estimates on such information as exists, recognising the inherent uncertainty. This assessment relies on information on planned and potential biomethane projects and is combined with a range for the number of companies involved in unconventional and conventional production.

On the basis of the available information, a plausible range for the number of companies benefitting from the exemption is 16–71 over a 10 year period. Combining this with the estimates for the administrative cost of a licence application (see above)[4] gives a range of Net Present Value of £0.16m- £0.67m. The central estimate is computed as the mean of this range, i.e. £0.36m.

Other key non-monetised benefits by 'main affected groups'

Key assumptions/sensitivities/risks	**Discount rate (%)**	3.5
The range of benefits is sensitive to the number of beneficiaries (i.e. the number of gas producers injecting to grid).		

BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			**In scope of OIOO?**	**Measure qualifies as**
Costs: 0	**Benefits: 0.04**	**Net: 0.04**	Y	**Out**

[1] Impact Assessment for Gas Licence Exemptions, DECC, 2011

[2] Please see Gas Licence Exemptions Impact Assessment (http://www.legislation.gov.uk/uksi/2011/232/pdfs/uksifia_20110232_en.pdf) for more information.

[3] Gas Licence Application Form, Ofgem Website

[4] Discounted at a rate of 3.5% per year

1. The policy issue and rationale for Government intervention

One of the activities that must be authorised by a transporter licence, as set out in section 5 of the Gas Act is 'the conveyance of gas through pipes to any premises, or to a pipe-line system operated by a gas transporter, other than by the means of a gas interconnector.' Thus, onshore producers of gas (including biomethane, shale, coal bed methane and conventional onshore) require a transporter licence to operate pipes that convey gas from the onshore production facility to the grid (both the low pressure Gas Distribution Network (GDN) and high pressure National Transmission System (NTS)).

However, the Gas Act provides the Secretary of State with the power to grant exemption from licensable activities. The purpose of exemptions is to reduce the regulatory burden for those people for whom holding a licence would be excessive or onerous and where it would not be reasonable to expect the NTS or GDNs to maintain and operate the pipeline.

The requirement to hold a transporter licence has been identified by the Energy Market Issues for Biomethane (EMIB) group as a barrier for biomethane sites who wish to inject to grid and the regulatory problem extends to other forms of gas that can be produced onshore.

An exemption would mean that onshore gas producers could avoid the costs of obtaining a licence (estimated between £1,000-£20,000) and/or modifying their company structure and behaviour to avoid the need for such a licence.

2. Policy objectives and intended effects

Removing this barrier to the introduction of new and alternative sources of gas supply (including renewables) will increase the diversity of supply to the grid, improving security of supply and creating additional grid balancing opportunities. It will also reduce the cost of market participation, which should help to promote growth, generate jobs and encourage UK investment in onshore gas production.

This exemption is aligned with government policy to remove red tape and supports objectives to encourage maximum economic production from UK gas resources. This exemption also backs the coalition agreement to support energy from waste (especially Anaerobic Digestion) by removing a barrier for biomethane injection to grid and supports Government's landfill reduction and decarbonisation objectives.

3. Policy option considered

Create a class exemption that applies to all onshore gas producers, which would remove the need and cost (for both industry and government) to either:

- approve individual named exemptions; or
- to obtain a transporter licence (where the producer is not already a licensed shipper or supplier).

4. Expected level of business impact

The regulatory change will affect only companies wishing to connect to the National Transmission System (NTS) or a Gas Distribution Network (GDN). Exemption from the need to obtain a transporter licence will lead to reduced administration costs. While the possibility exists that companies will apply for named exemptions, for the purposes of this assessment, it is assumed that companies wishing to inject to grid will apply for a

transporter licence due to the greater legislative uncertainty associated with obtaining a named exemption.

Previous analysis carried out for a similar regulatory impact assessment on Gas Licence Exemptions[5] indicates that the administrative cost associated with application for a transporter licence is of the order of £20,000 (in 2010 prices) which reflects the regulatory, legal, commercial and other inputs required in making the application. This figure is based on estimates quoted by energy consultants and is representative of 10-20 days of professional advice and IT investment to comply with various application requirements. This figure should be considered an indicative estimate based on informed judgment.

At the time, DECC judged that this is likely to reflect an upper limit on the grounds that efficiencies might be found in the application process. DECC's 2011 assessment took the view that the lower end of the range could be the cost of the application[6]. This gives a range of £1,016-£20,321 in 2009 prices. Industry intelligence from industry participants suggests that the original £20,000 figure should be unchanged. As a result the same assumption is used as the basis of the admin cost to business for this assessment.

Estimation of the number of companies affected in each case is not straightforward due to the high degree of uncertainty surrounding the future levels of UK onshore gas production, particularly with respect to unconventional gas and biomethane. It is therefore necessary to base estimates on the available information, recognising the inherent uncertainty.

The following types of businesses could potentially be affected by the regulatory change:

Conventional gas producers

Of the existing conventional onshore gas producers, only one (Wytch Farm) currently injects gas into the NTS and there is a named exemption in place for this site meaning the exemption would provide no direct benefit. There is potential for a reduction in administrative burdens to influence existing producers' decisions about whether or not to connect their production facility to the grid. However, the cost of the connection and the relatively small scale nature of existing conventional onshore production means that there is limited incentive to inject gas to grid on commercial grounds. Given the size of the administrative cost in the context of the costs of connection, the exemption is unlikely to form a significant part of the decision.

Future unconventional gas producers

There is currently no commercial gas production from unconventional sources in the UK, although commercial coalbed methane production may begin relatively soon. Were production in the UK to achieve a significant scale, unconventional gas production from shale or coal bed methane is likely to benefit from the licence exemption. However, the outlook is subject to a significant amount of uncertainty. Unconventional gas activity is still at a very early stage in the UK; the scale of the available resource is not clear, as are the prospects for actual production levels.

While there are a number of external estimates for UK unconventional gas production, these are subject to considerable uncertainty and are highly dependent on a number of factors

[5] Impact Assessment for Gas Licence Exemptions, DECC, 2011

[6] Please see Gas Licence Exemptions Impact Assessment (http://www.legislation.gov.uk/uksi/2011/232/pdfs/uksifia_20110232_en.pdf) for more information.

being in place[7]. There is currently one coal bed methane project expected to connect to the NTS (Aith) with production expected from 2013. For the purposes of this assessment, it is assumed that in the low case no further unconventional gas producers operate in the UK. This would correspond to a scenario where the barriers to production were such that no production could occur. For the high case, it is assumed that a total of ten unconventional gas producers are operating in the UK by 2022[8]. This should be treated as an indicative high-case scenario. DECC does not currently have a view of or the amount of unconventional gas that could be produced in the UK.

Biomethane producers

The two main sources for biomethane are anaerobic digestion plants and Bio SNG. Industry intelligence indicates that plans for Bio SNG in the UK are very limited and commercial production is unlikely before 2020 meaning it can largely be ignored for this assessment. Biomethane from anaerobic digestion is more promising. Assumptions for the number of new producers injecting to grid are based on industry intelligence - for projects out to 2015 it is suggested that between 8 and 33 new producers might inject gas to grid. After this, it is assumed that the number of new producers roughly doubles out to 2022 with a linear increase in the number of producers per year. For the high case scenario, this means there will be four new producers per year injecting to grid giving a total of 61 by 2022 while in the low case scenario, there is one additional producer per year meaning a total of 15 by 2022.

Taking this information together, the available information indicates that the number of companies that could benefit from a transporter licence exemption to 2022 is in the range 16-71. Combining this with the estimates for the central case administrative cost of a licence application (see above)[9] and the profile of start-up years as described gives a range of Net Present Value of £0.16m- £0.67m in 2009 prices and 2010 values. This relatively large range reflects the wide range of potential beneficiaries, which is itself indicative of the considerable uncertainty surrounding biomethane and unconventional gas production.

Impact on competition

As transmission networks are natural monopolies, regulation is required to ensure effective competition within the network. Therefore, it is important to ensure that the creation of this exemption will not promote anti-competitive behaviour by ensuring that the requirements of the EU Third Energy Package (including the Third Party Access Principle) will continue to be met.

The EU Third Party Access Principle aims to ensure that companies who are involved in the production and conveyance of gas do not abuse their position as operators of that network to obstruct access for their competitors. Therefore, the operators of the pipes that convey gas from the onshore production facility to the grid must ensure that any third party that wishes to access the network is not discriminated against.

A pipeline connecting a gas processing facility with a pipeline operated by a gas transporter meets the definition of 'upstream petroleum pipeline' for the purposes of s82 Energy Act 2011, which sets out third party access requirements in respect of such pipelines. Holders of this exemption will therefore be subject to the third party access principles, which require that infrastructure operators provide open and non-discriminatory access to those who do

[7] These include favourable geology, accessible land, favourable tax conditions, availability of water, environmental laws and the development of secondary service industries

[8] One company is assumed to start up from 2018 with two per year thereafter to 2022

[9] Discounted at a rate of 3.5 per cent per year in real terms

not own the physical network infrastructure. If the owner of the infrastructure and the person who wishes to use it cannot reach an agreement, there is a process (detailed in the legislation) to appeal to the Secretary of State. Thus, these companies, should they choose to inject to grid and benefit from the exemption would not be able to use their position as a network operator to discriminate against potential competitors. This provides an appropriate safeguard to ensure that the creation of this exemption will not have detrimental impacts upon competition.

Impact on SMEs

Micro-sized businesses will not be excluded from this proposed measure meaning that they will be able to benefit from the licence exemption in the same way as other organisations. While it is not possible to reliably estimate size breakdown of companies benefitting from the measure, however, for indicative purposes, it might be reasonable to assume that the biomethane producers would be micro-sized businesses (i.e. few than 10 employees) while unconventional producers are likely to be larger (though not necessarily 'large').

The following table shows the range of benefits under the different scenarios for injections to grid:

	High	Low	Central
Number of firms	71	16	44
NPV (£m)	0.67	0.16	0.36
EANCB (£m)	-0.08	-0.02	-0.04

5. Equivalent Annual Net Cost to Business and One in One Out

The EANCB is calculated to be in the range -£0.02m to -£0.08m with a central estimate of -£0.04m. This is a deregulatory measure, that has a net benefit to businesses therefore it should be classed as an "out" for the purposes of the Government's "One in, two out" policy on regulations affecting businesses.