Title: Government Pipeline and Storage System (GPSS) **IA No:** **Lead department or agency:** Ministry of Defence **Other departments or agencies:**	**Impact Assessment (IA)**
	Date: 27/11/2011
	Stage: Final
	Source of intervention: Domestic
	Type of measure: Primary legislation
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Summary: Intervention and Options

RPC Opinion: RPC Opinion Status

Cost of Preferred (or more likely) Option				
Total Net Present Value	**Business Net Present Value**	**Net cost to business per year** (EANCB on 2009 prices)	**In scope of One-In, One-Out?**	**Measure qualifies as**
[text redacted]	£m	Benefit of [text redacted]	No	In/Out/zero net cost

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

The GPSS provides aviation fuel for both military bases and commercial airports in the UK. MOD has previously reviewed the pipeline and concluded that it does not need to be owned by Government. There are currently restrictions on developing the system for greater commercial usage unless there is an underpinning defence requirement. Legislation is required before the GPSS can be sold.
There is also a requirement to restore the Secretary of State's rights of access to private land under which the GPSS runs which over time may have been lost due to non-registration of those rights and subsequent changes in land ownership

What are the policy objectives and the intended effects?

To sell the GPSS in order to generate a significant capital receipt for Government, thereby reducing the public debt; enable even greater commercial exploitation of the system and capital and maintenance investment to improve its resilience; and avoid future liabilities
To ensure that a privately operated GPSS continues to meet Defence needs and does not gain a competitive advantage compared to commercial pipelines. Once sold, the GPSS will be operated under a similar regime to civilian pipelines constructed under the Pipe-lines Act 1962
To restore any lost rights

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

A "retain in Government" option has been considered as an alternative to sale, but this would not meet the policy objectives, both in achieving a receipt and enabling greater commercial exploitation.

Given the low level of military use of the asset, its continued importance to the civil aviation sector and the results of our market testing, we believe GPSS is suited to private sector ownership. An Initial Investment appraisal has been undertaken but more work is required by summer 2013 to confirm that sale will provide value for money, prior to a final decision to sell.

Will the policy be reviewed? It will be reviewed. **If applicable, set review date:** mid 2013

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** No	**< 20** No	**Small** Yes/No	**Medium** Yes/No	**Large** Yes/No
What is the CO_2 equivalent change in greenhouse gas emissions? Not known (Million tonnes CO_2 equivalent)			**Traded:**	**Non-traded:**	

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 .... Date: 13/11/12

Summary: Analysis & Evidence

Policy Option 1

Description: Retain in Government ownership

FULL ECONOMIC ASSESSMENT

Price Base Year 14/15	PV Base Year 14/15	Time Period Years 30	Net Benefit (Present Value (PV)) (£m)		
			Low: [text redacted]	**High:** [text redacted]	**Best Estimate:** See Note:

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	Optional		Optional	**Optional**
High	Optional		Optional	**Optional**
Best Estimate	[text redacted]		[text redacted]	[text redacted]

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

*Government foregoes capital receipt of between [text redacted] and continues to pay annual running costs of the GPSS (around £30M) out of commercial income and meet the capital investment requirements (around £8M per annum).
Government also responsible for meeting any environmental liabilities (not quantified) and compensating landowners to restore any of Defence Secretary's rights that may have been lost (between £0 and £7.7M).

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

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	Optional		Optional	**Optional**
High	Optional		Optional	**Optional**
Best Estimate	[text redacted]		[text redacted]	[text redacted]

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

Government receives revenue from the United States Visiting Forces and commercial sources for the use of spare capacity (£39M) plus MOD does not have to pay (notional revenue of £13M)
Private sector benefits from OPA spend on maintenance, repair, capital investment

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

Key assumptions/sensitivities/risks — **Discount rate (%)** 3.5

Risk in future of insufficient investment from Government to maintain resilience of the system
Unable to exploit pipeline for purely commercial purposes, where no underlying Defence requirement.
Note: Low/High Net Benefit PVs taken from asset value sensitivity test.

BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m: 0			In scope of OIOO?	Measure qualifies as
Costs: 0	**Benefits:** 0	**Net:** 0	No	NA

Summary: Analysis & Evidence

Policy Option 2

Description: Legislation and sale

FULL ECONOMIC ASSESSMENT

Price Base Year14/15	PV Base Year 14/15	Time Period Years 30	Net Benefit (Present Value (PV)) (£m)		
			Low: [text redacted]	**High:** [text redacted]	**Best Estimate:** See Note:

COSTS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Cost** (Present Value)
Low	Optional	3	Optional	**Optional**
High	Optional		Optional	**Optional**
Best Estimate	[text redacted]		[text redacted]	[text redacted]

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

Purchase price of [text redacted] which has been classed as transition cost for the purposes of this IA.
Purchaser will also meet annual operating costs of GPSS, any capital investment requirements (around £8M), additional business rates (£4.1M) and certain notification requirements.
Government will incur transactional costs related to sale (£4.3M), annual service charge (assumed at £6.5M to £13.2M but subject to further work) and compensation payments to restore any lost rights.

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

Landowners - potential disruption from any expansion of the GPSS for commercial purposes

BENEFITS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Benefit** (Present Value)
Low	Optional		Optional	**Optional**
High	Optional		Optional	**Optional**
Best Estimate	[text redacted]		[text redacted]	[text redacted]

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

Government will receive a capital receipt [text redacted] and additional business rates (£4.1M).
It will also avoid running costs and capital expenditure, transfer some liabilities and, with private sector investment, potential for increase in resilience of a national infrastructure asset.
Purchaser - annual revenue (£39M of commercial income plus potential for growth, MOD service charge currently assumed at £6.5M to £13.2M)

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

Potential for increased investment in the pipeline in order to increase resilience of the system and allow greater commercial development . Any increased use of GPSS to supply commercial airports could mean less road tankers with associated benefit of noise reduction, less traffic disruption, reduction in greenhouse gases and improvement in air quality.
There is also potential for the GPSS to be used to supply non-aviation fuel.

Key assumptions/sensitivities/risks **Discount rate (%)** 3.5

Key assumptions are that a sale receipt will be obtained that delivers value for money, Government requirements can continue to be met post sale at an acceptable cost and that market conditions will continue to support the currently anticipated sale price until after the legislation has been approved
Current liabilities cannot be quantified until Land Quality Assessments have been undertaken.
Note: Low Net Benefit PV assumes halving of the projected service charge in base case IA. See page 10 for IA comparison of options.

BUSINESS ASSESSMENT (Option 2)

Direct impact on business (Equivalent Annual) £m:			In scope of OIOO?	Measure qualifies as
Costs: [text redacted]	**Benefits:** [text redacted]	**Net:** [text redacted]	No	NA

Evidence Base (for summary sheets)

Background

The Government Pipeline and Storage System (GPSS) was constructed before and during the Second World War and expanded during the Cold War. It consists of some 2,500 kilometres of pipeline and a number of other facilities and is managed by the Oil and Pipelines Agency (OPA), a Public Corporation, sponsored by MOD. The pipeline is used to receive, store, transport and deliver aviation fuel for the MOD and US Air Force. In peacetime military use amounts to only around 10% of the current throughput of the system and 60% of the current volumes stored in the system. Spare capacity is utilised by fee paying commercial customers, with the system distributing around 40% of aviation fuel in the UK including 100% of Stansted's requirements, 100% of Manchester's and 40% of Heathrow's and Gatwick's.

The GPSS was originally built under a mixture of agreements with private landowners, emergency powers in force immediately prior to and during the Second World War and a number of post war statutes. Under this legislation the Secretary of State has the authority to use the GPSS for defence purposes (and purposes not inconsistent with defence purposes) and to access the land through which it runs for maintenance and repair; however these rights cannot be transferred to a third party. Neither can the system be expanded for purely commercial purposes.

There is a requirement to restore rights which over time may have been lost due to non-registration of the Secretary of State's rights and subsequent changes in land ownership and to correct rights where the physical pipeline position does sit within wayleaves due to measurement errors when it was constructed. Modern tracking methods are being used to establish the true position of the pipeline.

In the Strategic Defence & Security Review the MOD committed to reducing running costs to allow resources to be focussed on the front line and identified non-front line savings of at least [text redacted] over the Spending Review period. This target will be achieved in part by the sale of business assets.

Problem under consideration

While the GPSS is an asset which is well suited to private ownership/operation and there is market appetite to purchase the asset, sale is not presently feasible due to current legislation. In order to sell the GPSS, primary legislation is required to create transferrable rights in relation to the land through which the pipeline runs.

Sale would remove the annual maintenance requirement and long-term (as yet unquantified) capital expenditure requirements on Government, thereby potentially increasing the resilience of the system.

Because there has to be an underlying Defence requirement before the GPSS can be developed for commercial purposes, the MOD/OPA is unable to invest in/develop all commercial opportunities, which leads to a piecemeal approach to the management of the pipeline

It is also necessary to restore any lost rights relating to the pipeline to ensure its ongoing operation.

Rationale for intervention

Intervention is required to sell the GPSS in accordance with the cost reduction policy set out in the SDSR. Sale would also enable greater commercial exploitation of the GPSS to meet both the current and future requirements of civilian airports.

In addition to enabling sale of the pipeline the intervention will restore lost rights

Policy Objective

The main policy objective is for the GPSS to be owned and operated by the private sector within the 2010 Spending Review period. This will generate a capital receipt for Government, thereby contributing towards a reduction in public debt.

Sale will also enable increased private sector investment in the pipeline in order to increase the resilience of the system and allow even greater commercial development.

The sale process will also provide an opportunity to restore rights that may have been lost over time, when land was sold without the Secretary of State's rights having been registered.

Options considered

Two options have been considered. Under Option 1 ('status quo'), the GPSS would remain in Government ownership and be run in accordance with the current Business Plan. Under Option 2 ('sale') the GPSS would be sold and the MOD would contract with the purchaser for its annual requirement – this is subject to further work.

A preliminary Investment Appraisal has been conducted looking at both options and a full Investment Appraisal will be provided following the passage of legislation and prior to a final decision to sell, reflecting a better understanding of the costs and benefits.

Under the status quo the MOD controls the asset and does not pay any annual charge for use of the GPSS and the GPSS receives cash income from the United States Air Force and commercial third party customers. Any surplus cash once the operating and capital costs are paid for accrues to the MOD, while equally the MOD funds any shortfall.

Under the sale option the MOD sells the GPSS in its entirety in return for a capital receipt and then pays an annual cash charge for its usage requirements going forward. The purchaser is responsible for operating and funding the GPSS going forward. The GPSS would no longer benefit from the crown discount on rates and be liable to pay corporation tax. In any transaction the MOD would seek to transfer risk to the private sector to the extent possible and to benefit from any increased investment / commercialisation. Depending upon its requirements, the MoD will also seek appropriate protections in any transaction structure, including to protect any long term interest in retaining access to the GPSS.

It has been agreed with the Department for Energy and Climate Change (DECC) that the legislative provisions will confer broadly similar rights and obligations on the owner of the GPSS as those applicable to the operation of a civilian pipeline constructed under the Pipe-lines Act 1962. This will ensure that a privately owned GPSS pipeline is not at a commercial advantage to its competitors. These provisions will include a requirement for the pipeline to be used so as to reduce the necessity for the construction of other pipelines and for the relevant Secretary of State to be informed of the abandonment of sections of the pipeline.

Whilst the legislation will provide for the OPA to be disbanded, it may still be required post sale to manage other MOD Oil Fuel Depots that are not being sold. OPA staff are not civil/ public servants.

Impacts - Costs and benefits

Financial/Economic

Sale will help contribute to paying down Government debt, which is a key Government policy.

It should also help ensure resilience of supply of aviation fuel consistent with military and civil aerospace requirements

There are potential opportunities for private sector development of the GPSS and use of spare capacity. This could lead to a reduction in the carbon footprint if more aviation fuel is delivered by pipeline rather than by road tanker and contribute to UK energy security by increasing strategic oil stocks. Further work is required in the next 12 months to assess the scale of these opportunities

In terms of impact on the market, there is the potential for the GPSS to operate complementary to the private pipeline network and the legislation will also allow for third party access to the pipeline so as to reduce the necessity for the construction of other pipelines, thereby facilitating competition where spare capacity exists.

Sale is not expected to lead to increased costs to customers although a purchaser may seek to increase revenues and profitability, subject to market forces. Private ownership should allow easier upgrades to pipe capacity in line with developing customer requirements.

The cost of operating the pipeline should not increase post sale since the GPSS is already operating under the same health, safety and environmental regime as private pipelines.

Sale is not expected to have a significant impact on the labour market

The introduction of provisions equivalent to those in the Pipe-lines Act 1962 will mean that DECC will be involved in regulation and oversight of the operator, with the MOD role restricted to ensuring national security requirements continue to be met. However the administrative burden for DECC will be no greater than for other commercial oil pipelines.

Social

The proposed changes will not result in any significant social impact. The restoration of any lost rights will impact on the rights of individual land owners but these changes are required in the public interest in order to reduce public sector debt and landowners will be compensated for the associated reduction in the value of their land.

Environmental

As previously stated there is potential to reduce carbon emissions but this is as yet unquantified and will depend on the plans of the buyer.

It is assumed that the asset will be managed to at least the same standard as that currently provided by the OPA, whilst the potential for additional capital investment in the GPSS might further reduce environmental and operating risks

There is no direct impact on the landscape or built environment.

Groups affected

There is an indirect impact on the 7,000-7,500 landowners under whose land the pipeline runs. They were compensated for any decrease in the value of their land at the time the pipeline was constructed and sale will not lead to any further decrease in land values. However, there will be a direct impact on landowners where the Secretary of State's rights have been lost and need to be restored, or where the physical pipeline position does sit within wayleaves due to measurement errors when it was constructed. These may need addressing irrespective of sale, but sale does crystallise the issue. Even though these landowners are already aware that the GPSS runs under their land since it is marked out at regular intervals, they will be compensated for the rights being restored or if the physical location of the pipeline is found to run under the land of a different landowner to the one who was originally compensated.

Those living in the vicinity of the GPSS may want to be assured that sale will not increase environmental or safety risks. This will not be an issue since the GPSS already operates under the same health, safety and environmental regime as civilian pipelines.

Landowners and other stakeholders have been consulted through a targeted exercise, which involved writing to all landowners on the MOD's database, writing to MPs and Councils through whose constituency/area the GPSS runs and placing advertisements in local newspapers.

Analysis

Level of analysis

An MOD level 4 Investment Appraisal has been completed, consistent with HM Treasury's Green Book, to demonstrate acceptable value for money implications of sale. However further work is required to refine the assumptions (see below) before a final commitment to sale is made. The MOD's economic advisers, DASA (DESA) [Defence Analytical Services and Advice - Division of Economic and Statistical Advice] are content that it is a fair comparison of options.

The final Investment Appraisal is likely to be complete in around 12 months time.

Since sale does not impose a direct annual net cost on business or civil society organisations the provisions are out of scope of 'One In One Out' (OIOO).

Time period

The assumed life of the asset is 60 years but a 30 year time period for analysis has been agreed with DASA DESA.

Types of Cost and benefits

Costs

1. To the purchaser
   - a one off purchase price of between [text redacted] with a current assumption of circa [text redacted]. This is likely to be impacted by the prospective MOD service charge.
   - annual operating costs. These were about £30M in 2011 and are unlikely to change significantly following sale
   - annual capital investment requirements. Whilst historically these are around £8M per annum, the long term capital investment requirements are not yet understood.
   - additional business rates of around £4M per annum

2. To Government
   - one off costs associated with preparation for sale. These are currently assessed at £4.3M and mainly comprise buying in external assistance to support the sale process.

Additional costs relating to undertaking Land Quality Assessments, digitising the wayleave records and updating the database of landowners would be incurred regardless of whether the GPSS is sold.

- an annual service charge of £13.2M. This is subject to work to identify fuel requirements to Future Force 2020 and, as noted previously, is likely to decrease
- compensation for landowners for lost rights or where pipeline is laid outside the wayleave. The maximum payable will be £7.7M although the true figure is expected to be significantly lower since it is dependent on the land having been sold and claims being raised by landowners. This liability also exists under option 1.
- Regulatory costs over and above those required for the Pipe-lines Act 1962 Act. These are negligible.

3. To landowners
    - No additional costs have been identified.

<u>Benefits</u>

1. To the purchaser
    - the potential annual income steam from Government (£6.5M to £13.2M)
    - third party income of £39M, with the potential for an increase prior to sale and for further growth post sale
2. To Government
    - a capital receipt [text redacted]
    - additional business rates (£4M)
    - no annual operating costs
    - the avoidance of capital expenditure and future (as yet unquantified) liabilities
    - with private sector investment, the potential to increase the resilience of a national infrastructure asset

3. Others
    - potential increased supply to civilian airports

Assumptions and sensitivities

Because there are a number of key areas which are subject to further work and revision, sensitivities were run to show the variability of the analysis to key assumptions. These sensitivities are as follows:

- an asset receipt is dependent on market conditions at the point of sale. A limited market testing exercise has been carried out by the Shareholder Executive to establish private sector interest in the GPSS. [text redacted] The indicative central valuation ranged from [text redacted] to [text redacted], excluding the lowest and highest bids. However the Investment Appraisal used a wider range in its sensitivity analysis since, if earnings increase in line with the current GPSS business plan up until the point of sale, then this should make the business more valuable to a potential buyer and the equivalent range would be between [text redacted] and [text redacted]

- capital investment is currently £8M a year. Long term capital investment could be between £4M and £12M per annum depending on requirements.

- a revised annual charge of £6.5M to reflect a decrease in the MOD requirement over time as the size of the Armed Forces reduces and a number of RAF bases are closed

- changes to the asset life to show a 0% and 50% as well as 100% residual value after 30 years.

- adjustment to the IA period to show the outcome over 10 and 20 years as well as a 30 years, to take account of changes to the asset life and the likely duration of the MOD requirement.

Potential Risks

The following items are key risks to sale :

Pre sale	
Vfm	Sale will not provide value for money
MoD Requirement	Future aviation fuel requirement will not be established in time
Landowner Compensation	GPSS has lost some of its rights due to non-registration of the Secretary of State's rights and subsequent changes in land ownership over the years and potentially also due to the historical inaccuracy of mapping techniques. Work is in hand to quantify these risks and although the legislation and potential sale does not cause or increase this liability, it may increase the probability of it being crystallised
[text redacted]	[text redacted]
Environmental	Extent of any environmental liabilities are unknown and Land Quality Assessments are being commissioned to establish this prior to sale
[text redacted]	[text redacted]
Commercial Upsides	Full commercial upside of the GPSS either under MoD ownership or if transferred to the private sector have not yet been fully analysed
Post sale	
MoD's ability to contract	Based upon its' requirement and particularly should the GPSS remain a monopoly supplier, as part of any sale the MOD will seek to procure any long term access required and protect the price it pays for the service
Assured future supply	MOD will contract for supply and its requirements for availability and priority and seek to enforce this through the transaction structure
Cost	Need to protect against long term increases in cost of the service
Bankruptcy	Any transaction will need to protect against a potential bankruptcy of the GPSS
Environmental liabilities	The extent of any environmental liabilities will not be known under Land Quality Assessments have been undertaken.

The impact of the risks will be quantified in time for the full Investment Appraisal in 12 months time

Wider Impacts

As noted above, one of the wider impacts is the avoidance of future liabilities arising from operation of the pipeline. These are both environmental, arising from an oil leakage/spillage, and commercial, due to a failure to supply commercial customers.

Results of the analysis and recommended option

An Investment Appraisal has been undertaken based on currently known metrics and including reasonable assumptions regarding the ongoing annual charge. Based on the anticipated asset receipt, transaction and ongoing service charges, with an assumed annual charge of £13M for MOD and taking account of receipts to other parts of Government from additional rates which are payable under private ownership (£4M a year), the IA shows a difference in Net Present Value of [text redacted] over a 30 year period (excluding any Corporation Tax paid post sale). [text redacted]. However, whilst option 1 provides best value for money in current circumstances, the Investment Analysis also shows that changes to the MOD service charge and/or commercial revenue stream could result in option 2 providing best value for money. We are working with the OPA to identify the restructuring opportunities which could enable these changes.

Summary

Whilst there is an enduring Defence requirement for the services provided by the GPSS, a review of the GPSS has concluded that it doesn't need to be owned by Government. Sale of the GPSS would generate a capital receipt in accordance with the cost reduction policy set out in the SDSR. It would also enable greater commercial exploitation of the GPSS to meet the current and future requirements of civilian airports. Primary legislation is required if the GPSS is to be sold, in order to create transferrable rights in relation to the land through which the pipeline runs. Once sold, the GPSS will be operated under a similar regime to civilian pipelines constructed under the Pipe-lines Act 1962