

Ian Marlee
Partner, Trading Arrangements
Ofgem
9 Millbank
London
SW1P 3GE

6th April 2010

project.discovery@ofgem.gov.uk

Dear Ian,

The Gas Storage Operators' Group Response to Ofgem's consultation on Project Discovery: Options for delivering secure and sustainable energy supplies

The Gas Storage Operators Group (GSOG) welcomes the opportunity to respond to this important wide-ranging review of the electricity and gas market arrangements. This is a non confidential response and as so the GSOG is happy for this to be placed into the public domain.

The GSOG is a trade association which was formed in May 2006 within SBGI. The group has 17 members, comprising almost all the active participants in the GB Gas Storage Market, and as such represents a wide range of interests. The group includes both established operators and developers of new storage projects, large multinational companies and smaller private ventures. The current members of the group and signatories to this submission are detailed in Appendix 1. StagEnergy (Gateway Gas Storage) considers that active consideration should be given to Level B Policy Options 'Enhanced Obligations' and therefore does not support the thrust of this response.

Our response is structured in two parts; firstly we offer some general comments on the review which we then follow by some responses to the questions posed in the consultation.

General Comments

We believe the challenges now facing the GB energy market in delivering secure, affordable and sustainable energy supplies are considerable. However, we do not believe that the case for wholesale reforms of the gas market has been made. Indeed, it would appear that much of the document relates to potential changes in the power market.

With particular regard to gas storage projects we believe that there are positive signs that the existing market arrangements are working with additional capacity currently under construction for example at Stublach and Byley and whilst we acknowledge that new investment has been delayed by a series of obstacles we hope that many of these have now been removed by the introduction of the Planning Act and the Energy Act. Further there is no shortage of potential developments with our analysis suggesting that if all planned and announced storage projects are delivered the GB market would have approximately 19bcm capacity equating to between 16% and 24% of average demand in 2020.

However, whilst the GSOG remains optimistic that the current market arrangements will eventually deliver the additional the gas storage capacity required to meet the demand for supply security and flexibility we do accept that there remains significant uncertainty regarding the timing of when these projects will go ahead. This uncertainty has been introduced by a number of factors which we believe could be addressed by the adoption of fiscal stimuli and risk mitigation measures.

The financial factors which have impacted on the timing of investment decisions for gas storage include the current collapse in the winter summer spread, the global recession and lack of liquidity in the capital markets and increased competition for capital. Whilst some of these are probably temporary distortions to the market it is crucial that there is an appropriate framework in place that provides the right incentives to invest in gas storage projects. Further, whilst we accept that these are phenomena beyond the control of any single Government or company, the UK does have the power to influence its domestic affairs. We believe that the harm caused by these factors could be in part remedied by the following fiscal stimuli:

- Grant capital allowances for salt cavern leaching costs currently denied;
- Provide 100% capital allowances for gas storage capital expenditure; and
- Reversal of excessive rental charges for offshore facilities by the Crown Estate.

While not a stimulus initiative as such, we have become aware of growing concern among member companies about the impact on the viability of projects of very significant increases in rateable values of storage facilities and we would urge a consistent, transparent and fair approach to Uniform Business Rates.

With regard to risk we believe that it is a duty incumbent on all stakeholders to reduce both the political and regulatory risk where possible; gas storage projects face a significant level of known market risks that investors are required to assess and quantify before making a decision; projects need consistent political and regulatory policy under uncertainty. Accordingly we very much welcome the publication of the Government's gas security of supply policy statement and in particular the statement confirming that it is against keeping national stocks of gas.

Further, we believe that the following risks and uncertainties need to be addressed as a matter of urgency if the required storage investment is to proceed in a timely way:

- Clarity on Ofgem's nTPA regime
- Removal of the threat posed by the Crown Estate's 'open market' rent review process

- Clarity on how the UK Government plans to implement the 3rd Energy Package

We do not, however, believe that it is particularly helpful to create uncertainty at this point in time by considering the more interventionist options for market reform as set out by Ofgem especially given the proven ability of the energy market to deliver new investment. We believe the market is not broken and as explained above the main barriers to investment are fiscal – rather than market – driven.

In conclusion, it seems to us that Ofgem should be cautious in proposing wholesale change, unless there is a compelling case for such change. Ofgem has identified some reasonable concerns in its document, but we would refute that there has been genuine market failure, particularly in gas, given the scale of recent investment in new supplies by industry serving GB's market.

Our final point in this section concerns the potential conflict that may arise when the setting and implementation of policy is effectively undertaken by the same body. We believe that the cornerstone underlying the constitutional principle of the doctrine of separation of powers is that the excessive concentration of power in one body does not best provide for effective and efficient government.

Responses to Questions

We now turn to the questions raised in the consultation.

Question 1: Do you agree with our assessment of the current arrangements?

The GSOG can offer only some support to Ofgem's assessment of the current arrangements. In terms of future investment, we agree that cost and availability of finance remains the key challenge for a multitude of reasons. We believe however that this challenge can somewhat be lessened by improvements such as improving price signals and more fiscal stimulus, albeit the latter is beyond the direct powers of Ofgem. We also believe that the current gas market rules could be improved upon, but we would not support wholesale changes.

Question 2: Are there other aspects of the current arrangements which could have a negative impact on secure and sustainable energy supplies, or costs to customers?

For the reasons set out by Ofgem in paragraph 3.57, the attractiveness of storage investment is weakened when it is placed alongside other infrastructural investment which may be competing for cash. This effect is heightened by the fact that many potential developers operate internationally and there is competition for capital also in other territories that may have a more welcoming approach. In this light, the importance of better fiscal measures is heightened and it is imperative that we see reform in this area.

Question 3: Do you agree that the five issues we have highlighted are the most important?

1. Agree
2. No view
3. Agree

4. Agree with Ofgem that there is a risk that political considerations may override the economic decisions impacting on the production of gas and the free flow of energy from international markets. That said, we do believe that the UK remains well placed to secure access to international gas and the concerns about access to gas in continental markets is over-stated, given progress with liberalisation of EU gas markets etc, although there remain many imperfections.
5. Agree

Question 4: Do you have any comments on our description of what might happen if no changes are made to the current arrangements?

In relation to gas storage, GSOG can support Ofgem's view that there is likely to be reduced investment in long range storage compared to that in fast cycling storage as set out in paragraph 3.57. As mentioned in our response to question 2, improved fiscal measures can help make the investment more economical.

CHAPTER: Four

Question 5: Do you believe that our policy packages cover a sufficient range of possible policy measures?

GSOG believes that Ofgem presents a reasonable range of policy measures. We do however believe that some measures suggested are too radical. In designing any policy packages, GSOG believes Ofgem do this under the leadership and with the maximum engagement of the Government, thus enabling a wider range of policy measures to be considered for implementation, such as fiscal stimuli.

Question 6: Do you have suggestions for variants to these policy packages?

In relation to the measures that Ofgem has indicated as possible alternatives to the policy packages, we believe that, in order to achieve some of the key objectives stated in the document, it could be really useful also to consider these tools:

- government loans for strategic projects;
- progressively tightening restrictions on carbon dioxide emissions from generating plant.

Question 7: What other policy measures do you believe should be considered, and why?

We would fully support the consideration of fiscal measures as detailed in our previous section to encourage investment. We believe however that Ofgem cannot achieve this on its own and Government engagement is essential.

CHAPTER: Five

Question 8: Do you agree with the assessment criteria that we have used to evaluate the policy packages?

GSOG broadly agrees with the assessment criteria.

Question 9: Do you have any comments on our initial assessment of each of the packages?

GSOG believes that the assessment requires validation by proper quantitative evidence.

Question 10: Do you agree with our summary of the key benefits and key risks of each policy package?

Confirming the need for quantitative evidence (see question 9), we have concerns about some of the policy packages that Ofgem has presented.

Concerning "Targeted Reforms" we believe that it isn't an adequate tool to increase the level of investments. Setting a minimum carbon price and improving short term price signals aren't sufficient measures when the companies have to implement very costly and long-term investments.

Regarding "Central Energy Buyer" we believe that moving away from the competitive market isn't a real option to obtain the development of new infrastructure and security of supply.

About "Capacity Tender" we think that this policy package could generate improper and unnecessary costs to customers, in particular for the difficulty to determine the market capacity needs.

Question 11: Do you have a view on which package is preferable or alternative policy measures or packages that you would advocate? We are particularly interested any analysis you may have to support your views.

GSOG would be supportive of a policy approach which improves the gas price signals required for storage development, and which works with Government in developing fiscal incentives to encourage investment.

CHAPTER: Six

Question 12: Do you agree with our assessment of the timing for important investment decisions?

GSOG believes that the three year lead time for storage projects is unrealistic, misleading and based on best case. We submit that decisions on storage investment need to be concluded imminently to guarantee 2015 delivery.

Question 13: Do you believe that early actions should be considered?

Given the current summer/winter price differentials, we urge fiscal measures to be considered immediately in relation to gas storage investment.

Question 14: Do you think that the issues are such that policy measures should be considered as a package or should they be considered on a case by case basis?

We believe the measures should be considered on an urgency and importance basis, with those ranking highest being resolved first on an individual basis, and implementation of solutions expedited. Beyond resolution of the highest ranking issues, we see no difficulties in then considering those remaining in the form of a package.

We hope that you find our comments of use and would be happy to discuss these further with Ofgem if you believe this to be of value.

Yours sincerely



PP

Roddy Monroe
Chair – SBGI Gas Storage Operators Group

Appendix 1

List of Members of the Gas Storage Operators Group:

Bord Gais Eiereann
Canatxx Gas Storage Limited
Centrica Storage Limited
Cheshire Cavity Storage Group
E.ON Gas Storage UK Ltd
EdF Trading Gas Storage Limited
ENI UK Gas
Gateway Gas Storage Company Ltd
INEOS Enterprises
Infrastrata plc
National Grid LNG Storage
Scottish Power Energy Management Ltd
SSE Hornsea Limited
Star Energy Group plc
Statoil (UK) Limited
Storengy UK Ltd
WINGAS Storage UK Ltd