BG GROUP

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Dear Peter,

Gas Security of Supply Significant Code Review

BG welcomes the opportunity to provide comments on the SCR consultation, having participated in both the Review Group 0260 in autumn 2009 and the SCR process this winter. We believe that the timing of the review is appropriate and fits with ensuring UK adherence to the European Security of Supply Regulation published on 20th October 2010.

The outcome of the Significant Code Review must be to recommend an approach that should (a) minimise the risk of occurrence of a gas supply emergency occurring and (b) in the event that it does occur, ensure that the situation can be corrected as quickly and as safely as possible. We believe that the new regime should be in place ahead of this Winter 2011 based upon DN exit becoming firm then.

Key messages:

- Critical role of NGG and NEC in ensuring safety of natural gas networks pre and post gas supply emergency
- Clarity on market rules, so participants know how best to respond in terms of supply contracting approach and what to do if and when an emergency occurs.
- Given Exit reform, it is essential that Shipper / suppliers and end-users ensure that there is commercial pre-contracting for Demand Side Management ahead of winter 2011.
- If the consumer is expected to pay more, then there needs to be a tangible improvement in security of supply in return.
- The new regime needs to maintain confidence and investment in the gas sector.

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Consultation Process

In terms of the consultation process for the SCR, we appreciate that Ofgem have sought to be inclusive in the discussion process, holding additional workshops and bilateral meetings outside the two public meetings and three workshop sessions. Whilst there has been some criticism of the exclusive nature of the workshops, we believe that, as with the Mod Panel, attendees were there to represent wider "aligned" interests rather than just those of the company they work for. The group size and balance of contributions in the workshops was about right although we did feel that the meetings didn't spend enough time exploring key issues in depth, so if this approach were to be repeated, We would suggest blocking out full day sessions and making use of the experience in the room to refine views on the subject matter at hand.

Given this, there is a danger that the workshops have focused perhaps too much on price and have not considered other approaches to the primary objective. The workshops have also failed to distinguish properly between the rapid onset of a gas supply emergency and one where conditions build up over a number of days, perhaps due to cold weather or to international supply disruptions. We believe it is important for the whole market to understand the implications under both scenarios.

Existing position

We believe that Mod 260 and the associated Ofgem guidance notes on post emergency Claims already provide Shippers with additional comfort in order to maximise supplies into the UK market prior to and during an emergency scenario. Whether it is a sufficient step is not clear, as we are not aware of any contractual arrangements being made with continental sources of gas that don't already have direct access to UK markets (theoretically this could tap into commercial interruptible consumers in Belgium / France / Germany / Netherlands – see Demand Side Management). Most of the continental "shippers" as opposed to suppliers would have active trading businesses within the UK NBP market, so they could already compete on the OCM market...the purpose of Mod 260 was to attract new sources of incremental supply to the UK (assuming that the Interconnector is not already at maximum reverse flow). Similarly, LNG supply arrangements would need to be secured in advance by signing up to UIOLI or commercial terms or being prepared to sell cargoes on a DES (Delivery ex ship) basis.

Demand Side Management

Given the reform to exit arrangements, whereby all exit capacity is firm from October 2012, there is a significant new firm demand load (circa 40-60mcm/d) which NGG had previously been able to interrupt to avoid a GSE.

Whilst BG do not have direct end-users in the UK market, we are aware of the evolution of interruptible contracts from the 1990s to date and the distrust that developed over shipper nominated interruption.

We believe that the priority as part of this review, is to ensure that there is proper pre-contracting for commercial interruption or demand side management. The ability to call on these options should be linked to NGG declaration of a Gas Balancing Alert. By pre-contracting (and perhaps declaring the quantity to NGG prior to the start of winter), the shippers would be comfortable that demand side management will play a part in avoiding a gas supply emergency. It will also give the consumers the comfort that they are only losing load that is "economic" for them, i.e. it enables them to keep the minimal supplies that avoid costly plant damage, rather than more likely facing NGG isolation. This was one of the clear messages that we took from participation in the SCRs and we need to ensure that the major users are an integral and willing part of the solution to avert and to manage any emergencies.

Stock holding obligations

If in the view of the Government, informed by TSOs, that rising import dependency and uncertainty of attracting LNG supplies has led to an increase in the supply risk to either the wholesale or retail markets, then there are steps that can be taken to mitigate these risks progressively.

If it were decided that pre-winter working gas stocks should be for example 5.0bcm in 2015 and 6.2bcm by 2020 (up from 4.5bcm in 2010), then this level of stock cover could be achieved by the introduction of a compulsory stock obligation on suppliers from 2015, based on their sales to consumers in previous years (or projected sales if significantly different). This stock holding could be held in storage, LNG tanks or potentially in continental Europe when associated with firm transportation capability back into the UK. These stocks would be freely useable by the stock holder during the winter, avoiding the real risk under other proposals of flexibility being with held from the market place. Such a move would create demand for additional storage in a climate where seasonal projects appear unattractive.

The analogy to this proposal is the reform within the oil sector and the compulsory stock obligation which is due to be published by the Government in spring 2011. There are a number of challenges in this area that merit further discussion, for example who is responsible for the stock holding (shippers / suppliers / NGG / public funded agency)

Gas Quality

As part of the review on preventing a gas supply emergency, BG believes that it is essential that Ofgem address the issue of potential gas quality constraints at Zeebrugge – IUK entry point. DECC cite IUK imports at 70mcm/d as the largest import source under the N-1 test (to be replaced by Milford Haven once Tirley PRI is constructed) and we are aware that Fluxys have written to Ofgem to highlight the practical and very real risk that flows could be curtailed into IUK due to Zeebrugge gas sources being out of spec with GSMR. The probability of quality constraints occurring is likely to increase due to changes in continental flow patterns and as Ofgem are aware, it is likely to take a few years to physically address the problem (through nitrogen ballasting / injection)

Price levels and role of VOLL

Whilst Value of Loss Load was an interesting concept to consider, it is clear from the workshops that it is not practical to have a known VOLL as the capped price in the event of an emergency occurring. It is clear that there is no single "VOLL" as end-users are likely to have different levels, including some industrial users with potentially higher VOLL than domestic consumers if full economic costs are taken into account. If a dynamic cashout price is permitted, then at the cusp of transitioning into an emergency the market price is likely to be rapidly drien upto the declared VOLL level. We therefore consider this an unhelpful element in determining the appropriate solution for an emergency.

It is clear that for a gas supply emergency to be avoided, prices in the UK need to be sufficiently high (and higher than substitutable markets) to attract the gas supplies that are required. But given the risks associated with very high prices (the reduction of shipper to shipper trading, the significant draw down of credit and potential shipper administrations, as well as the damage that would be done to gas within the UK energy mix and to the UK economy from a super-peak price), the proposed solution needs to be carefully balanced to create the right incentive without pushing reputable market participants away.

Questions to answer by chapter:

Chapter 3:
Question 1: Have we captured the appropriate range of options for reform of the gas emergency arrangements? Are there other options that should be considered?

We would like the review to consider what contractual efforts have been made in the light of Mod 260. We believe that consideration should be given to stock holding obligations and we consider it essential that there is real pre-contracting for demand side management ahead of winter 2011.

Question 2: Of the three options presented, which do you prefer? And Why?

If we are forced to choose between the Ofgem options, then we would prefer to take a "mix and match" approach as highlighted in Appendix 1. Having said that, our preference is that the appropriate solution is applied to the specific situation; we are not convinced that a "one size fits all" approach is appropriate or effective in this situation.

Question 3: What is the appropriate role for NGG in an emergency

We believe that NGG should continue to hold the National Emergency Co-ordination role. However it became apparent that the NEC role is solely focused on gas networks and we believe there needs to be additional consideration of the effect on the power sector – clearly avoiding a gas emergency must take precedence as gas fails to danger, but trying to keep the lights on is also a critical consideration. Further consideration needs to be given to how a "Command and Control" approach can fit with a market continuing to function (apart from the former being physical and the latter being commercial).

Question 4: Do you have any comments on our initial assessment of the pros and cons associated with each option

They are a fair reflection of the options presented but we believe the options are too restrictive.

Question 5: Are there any safety case implications associated with each option?

This is aimed at National Grid, but we'd refer to our comments in Question 3 above.

Question 6: What benefits would dynamic cashout bring relative to the post emergency claim arrangements?

Dynamic cashout would enable the marginal provider to receive a known price rather than relying on justifying the price to a regulator ex post. By removing the uncertainty, it is likely to encourage more physical molecules to the UK. However, if there is pre-contracting with European players who currently don't have access to the UK NBP market, then some of this uncertainty can be removed because it would set out the economic rationale for the price (eg ability for major industrial user to switch over to alternative fuel source or to use electricity instead of gas as part of the process).

Chapter 4:

Question 1: Are there any reasons why industry might not respond adequately to sharper price signals; thus delivering sub optimal security of supply? How could these be overcome?

We believe that the market is already effective at responding to price

Question 2: What are the likely barriers to attracting gas imports during a GDE? Could these be overcome?

Predominantly these will be pre-contractual issues. There needs to be some "excitement" in the market place that putting provisions in place is a good idea! This includes terms for LNG regas terminals (capacity and ship vetting) as well as with continental players who do not have access to the UK market as part of their normal business.

Question 3: Do you think that the risks associated with sharpening price signals make it necessary to apply additional obligations on relevant parties?

We've outlined our views above – we believe that the stock holding merits further consideration and would not lead to stifling market flexibility which would be our primary concern for some proposals in this area.

Question 4: If enhanced obligations were applied, to whom should they be applied and why?

Preference is on the supplier, but consideration could be given to creating a public body that manages this and collects a p/kWh fee for the annual service that is on everyone's (domestic) gas bill.

We trust that our response to the Initial consultation is clear and helpful. Subject to availability, we are willing to discuss this response in further detail and look forward to continuing to contribute as proposals are firmed up.

Yours sincerely

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Appendix 1:

Pick and mix to options presented.

Element	Current arrangements	Option 1	Option 2	Option 3
Shipper-to-shipper trading	Continues	★ Continues	Suspended	Suspended
Cash-out price	Frozen	★ Dynamic	Dynamic	Frozen
Post emergency claims	★ Required	Not required	May be required for domestic supply	Required
Role of VoLL	★ None	Administrative price cap(s) at VoLL	Administrative price cap(s) at VoLL	Administrative price cap(s) at VoLL
NGG role	No market balancing actions	Market balancing actions set cash-out ★	Market balancing actions set cash-out; Sole purchaser of gas from non-domestic sources	Sole purchaser of gas from non-domestic sources
NEC role	★ Authorise firm load disconnection; Authorise instruction of maximum flows from domestic sources	Authorise firm load disconnection	Authorise firm load disconnection; Authorise instruction of maximum flows from domestic sources	Authorise firm load disconnection; Authorise instruction of maximum flows from domestic sources
Compensation for firm customers disconnected	None	★ Compensation at administrative VoLL(s)	Compensation at administrative VoLL(s)	Compensation at administrative VoLL(s)

★ Represents preferred option

NB Compensation for firm disconnected load should potentially exist BUT not at arbitrary VOLL. Please refer to the CEPS November 2010 study for an estimate on VOLL in both gas and power for UK, French and Italian households.