

Mr Peter Sherry
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Dear Peter

RE: Gas Security of Supply Significant Code Review (SCR) Initial Consultation

The Gas Storage Operators Group (GSOG) welcomes the opportunity to respond to this consultation on Ofgem's thinking on GB security of supply, which is being conducted under the guise of a Significant Code Review (SCR). The response is not confidential and may be placed in the Ofgem library.

GSOG is a trade association which was formed in May 2006 within the Society of British Gas Industries (SBGI). The Group has fifteen members and comprises of 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 A.

Overall we welcome this opportunity for a thorough review of GB gas supply security and agree with Ofgem that whilst incremental improvements have been made, the modification process has proved to be a major obstacle to reform as discussions to date having tended to be narrowly focused and piecemeal. We also believe that the timing of the review is right given the relative benign threat to GB supplies and the time this allows for any long run solutions to be implemented.

Ofgem has identified the key objectives of the review as being:

- To minimise the likelihood of a gas emergency occurring,
- To minimise the duration and severity of a gas emergency if one was ever declared, and

- To appropriately compensate firm consumers if they were to be interrupted

Whilst GSOG agrees that these are reasonable objectives for the review, we are concerned that the consultation document focuses to a large extent on what happens to the cash-out price once a gas supply emergency has occurred and does not appear to give sufficient weight to preventing one from happening. GSOG firmly believes that prevention should be the primary focus of this review; gas imports are still set to increase, with the UK dependent on gas in the transition to a low carbon economy for the foreseeable future. Even when significant renewables (mostly wind) are on the system in the 2020s, fossil fuel generation like flexible gas, will be required as an essential back up as wind is intermittent.

Whilst GSOG notes that there has been a huge recent increase in import infrastructure, the UK now has nearly 135 bcm of import capacity, rising to c. 140 bcm over the next 9 months, compared to annual demand of less than 100 bcm. However, our growing import dependency has raised concern over a possible “supply crunch” because gas is an internationally traded commodity and, save for contracted volumes, can ‘follow the money’ on short notice; GSOG believes that new UK gas storage build will be an important mitigation of short term supply disruptions.

Whilst GSOG welcomes Ofgem’s proposal, as part of this review, to consider the case that the industry may not respond adequately to sharper price signals and hence the need for obligations (including storage obligations), we believe that Ofgem should give equal emphasis to the broader issue of why gas storage investment is stalling. The GSOG offers the following thoughts as to why this is happening.

First, there are other non market barriers to storage. These are principally DCLG’s Planning Act 2008 which is blocking approximately 10% of the potential projects, and regulatory uncertainty, which could be blocking up to a further 25% of the potential projects.

The regulatory uncertainty relates to Ofgem’s implementation of the EU third package with regard to “unbundling”, third party access and associated pricing limits. This is inhibiting investment by large vertically integrated companies which view storage as an integrated part of their whole gas chain activity. GSOG therefore takes the view that there needs to be close linkage between the SCR and Ofgem’s current work on the third package. In this regard we were encouraged by Andrew Wright’s comment at the Closing Seminar that care should be taken that our gas market rules do not get too out of line with Europe. We are in danger of having the most regulated storage industry in Europe; we will not only have the 3rd Directive and Regulation to contend with, the consequential UK implementation of those EU rules, but also the Ofgem guidance.

However for the bulk of the projects the paramount problem is the absence of the price signal. This is demonstrably the case in that most of the projects were initiated

during the period 2005 to 2008 when the forward price signal was present, and have all stalled now that this signal has disappeared.

Storage projects are high risk (technically and commercially) and entail major expenditure and commitment of resources on the part of developers over a number of years. Financing is exclusively from the private sector and the projects must compete for funds with other potential investments (often in other jurisdictions) where risks and rewards may be more attractive. We refer Ofgem to the GSOG response to the consultation on Guidance on the Third Party Access Regulatory Regime for Gas Storage Facilities and in particular to the references made to the potential harm that reserve prices set with reference to marginal cost may have on investment decisions.

Therefore there needs to be a consistent and strong price signal over a number of years to incentivise a significant number of new storage projects. It is difficult to see how balancing market changes will produce such a signal because until there is an actual supply failure markets will find it impossible to price in the risk – a good (or bad) parallel is perhaps the banking crisis of 2008. Providing such a price signal is a complex and multi faceted issue involving a number of Government agencies and deserves greater examination.

The GSOG would welcome the opportunity to engage with Ofgem on the possible options, both market and fiscal, that should be considered as part of the debate on minimising the risk of a gas emergency occurring.

Yours sincerely



Roddy Monroe

PP Chair – Gas Storage Operators Group

APPENDIX 1

SBGI GSOG MEMBERS

Centrica Storage Ltd
Cheshire Cavity Storage Group Ltd
E.ON Gas Storage UK Ltd
EDF Trading Gas Storage Ltd
Eni UK Ltd
Gateway Gas Storage Company Ltd
Halite Energy Group
INEOS Enterprises Ltd
Infrastrata Plc
Scottish Power Energy Management Ltd
SSE Hornsea Ltd
Star Energy Group plc
Statoil (UK) Ltd
Storengy UK Ltd
WINGAS Storage UK Ltd