

20th February 2011

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Dear Andrew

Significant Code Review – Gas Security of Supply

I am writing on behalf of the Major Energy Users' Council (MEUC) which is an independent consumer led body representing the interests of a large number of industrial, commercial, retail and public sector organisations and for which the use of electricity and gas is a significant factor in their operations' costs.

The Major Energy Users Council welcomes this SCR being carried out by Ofgem and in particular the opening statement made by Ofgem of,

1. The priority is to avoid an emergency
2. To get out of an emergency as soon as possible by attracting more gas
3. To compensate firm customers that are interrupted

Having had the privilege of attending the three workshops I have formed the following views that are not necessarily in the same order as the above priorities.

Considering the three options for reform suggested by Ofgem, I have for some time considered it wrong to freeze the cash out price in an emergency, which would lead me to eliminating option 3. The differences between Options 1 and 2 are that shipper-to-shipper trading is suspended making NGG the sole purchaser of gas and that post emergency claims may be required under option 2.

It is questionable whether NGG have the same level of contacts and knowledge required to take on the sole purchasing role in an emergency and the settling of post emergency claims can be complex. Both of these would lead me to eliminating option 2 leaving option 1 as the way forward if the arrangement are to be reformed. However there is one suggestion common to all three options that I would question and that is to use a Value of Lost Load (VoLL) to cap the market. The cap could actually be lower than the old frozen price and it will also be a known value that could become the target price at stage 2 of an emergency.

The suggestion that compensation payments for firm customers who are forced to stop taking gas in an emergency is most welcome and a change that MEUC supports. We have long argued that it is unfair that customer whose load is predictable and fairly static (I&C) should have to suffer by being interrupted without compensation to protect customers whose demand can increase dramatically thus causing the emergency (domestic).

Moving on to considering the Value of Lost Load that Ofgem has listed in a paper at being between £2 and £52 per therm, I do not have the expertise to determine a suitable level. I will however say that I have examined the last time we saw gas at £2 per therm in March 2006 and see that although the demand side did respond at this

level there was more load stayed on the system than came off. I would therefore suggest that the bottom value is somewhat higher than £2 per therm.

The final area for consideration was that of Obligations to be put on either shippers or transporters. The three obligations suggested By Ofgem are, long term contracts, strategic storage and demand side reduction (interruptible contracts).

Considering each in turn.

LONG-TERM CONTRACTS. Obligations on shippers/suppliers to have long-term contracts while a welcome development raises a number of questions the first being how it will prevent an emergency happening? Would the contracted gas only be usable after a GBA has been called? If not surely the supplier would use it first on a high demand day giving no protection. The second question is how long is long-term, is it to cover the next winter or is it ten years? The third is how much of a shippers volume would have to be contracted? Because of these questions I do not believe that this obligation would prevent an emergency from happening.

STORAGE Extra storage would be most welcome in the UK however an obligation for shipper/supplier to hold a percentage of their demand would be meaningless unless it could not be used until a GBA was called. If this was part of the existing storage available, withholding a volume until the last minute would leave the market short compared with existing arrangements. If it were new strategic storage this would be extremely expensive, as it could remain idle for many years without being used. The top up gas regime could be re-examined however National Grid carried out an exercise based on winter 2004 that showed a cost for top up would have been £200 million.

DEMAND SIDE REDUCTION. An obligation on shippers/suppliers to contract for demand side reduction (commercial interruption) would be impossible for domestic suppliers. This may be available in the future with the development of smart meters but this is many years from being achievable. For Industrial & Commercial suppliers, who may have consumers who could respond, they would not be able to recover the contracted cost from the remainder of their customers.

The Obligation that had almost total support in the workshop was for the Systems Operator (SO) to contract for demand side response (interruptible contracts) up to a predetermined volume. The method preferred by consumers would be an option and exercise scheme either using an auction or fixed price scheme. National Grid Electricity already contracts for demand side reduction.

Over the last number of years the Network Emergency Co-ordinator (NEC) has had one hand tied behind their back through changes to the interruptible regime. The NEC can call for additional gas onto the market but no longer can they call off demand before declaring a Network Gas Emergency. If the SO contracts for demand side reduction to operate after a Gas Balancing Alert is called this would give the NEC an extra tool to prevent an emergency. By reducing demand at GBA this will release gas onto the market helping to depress prices.

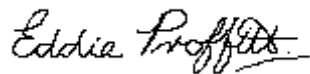
So in summary MEUC would support option 1 of the proposed market reforms but without a cap at VoLL.

MEUC welcomes the proposal for compensation to be paid to firm load customers forced to stop taking gas in an emergency.

On obligations MEUC believe that the one most likely to prevent an emergency having to be called is an obligation on the System Operator to contract for demand side response at a Gas Balancing Alert.

This submission is not confidential.

Yours truly,



Eddie Proffitt
Gas Group Chairman