

**Gas Security of Supply: Significant Code Review (SCR)
Ofgem's Initial Consultation, ref: 02/11**

Introduction

Oil & Gas UK is the leading trade association for the offshore oil and gas exploration and production (E&P) industry in the United Kingdom, with more than 100 members from the largest international oil and gas companies through large, medium and independent operators and utilities with E&P businesses to non-operators and a wide range of supply chain and support service companies. The sector has consistently been the largest industrial investor in capital assets in this country during the past 30 or more years. It supports about 450,000 jobs throughout the British economy and is one of the largest payers of corporation tax. In 2010, production from the UK's continental shelf satisfied more than 90% of the country's demand for oil and about 60% of demand for gas.

General Comments

We welcome this opportunity to contribute to the debate; rightly, security of supply demands considerable attention among policy makers, but we remain puzzled by the narrow focus of this SCR on the cash-out price in an emergency.

Firstly, preventing an emergency should be the principal objective for policy makers, regulators and market participants alike. The consultation document concentrates on curing an emergency rather than preventing one. Furthermore, the proposals seem likely to condense stages 1 and 2 of the emergency arrangements and hasten stage 3 which would not be good.

Secondly, there is a lack of definition of the perceived problem. Against which standards is security of supply being measured in this context? What is the likelihood of an emergency arising? These are not clear.

Thirdly, are there other simpler solutions which offer better value for money? We have always understood that interruptible contracts demonstrate the best cost-benefit ratio and yet their role will be much diminished by the market reforms which are already in hand. This is perverse; in extreme conditions during early January 2010 when demand peaked, constraints in parts of the distribution network led to rights of interruption being exercised which ensured that firm customers remained fully supplied. A potential emergency was thereby avoided.

We now turn to the specific questions raised by Ofgem.

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 think not. There are two notable ways of preventing an emergency which have not been considered in the consultation document:

- i) **interruptible contracts:** these offer the most cost effective means of avoiding an emergency and yet their role is going to diminish in the near future; this shortcoming should be addressed;

- ii) **gas quality:** owing to the different specification of gas between mainland Europe and Great Britain, there is a significant chance that supplies through the Inter-Connector and, once Nord-Stream has been commissioned, perhaps BBL as well will be restrained in future by a lack of treatment facilities for blending or ballasting imported gas flows in order to meet GS(M)R 1996; we made this point in both of our submissions under Ofgem's Project Discovery in 2009-10.

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

We are not persuaded by any of them, not least because all three depend on VoLL which is very difficult to determine, as Ofgem's Technical Annex demonstrates. At face value, VoLL is the equivalent of consequential losses which would be punitive and likely to lead to severe financial difficulties for all but the largest shippers. In turn, this would lead to fewer shippers, less liquidity and a less competitive market. This would be a damaging outcome.

In addition, options 2 and 3 give NGG a sole purchasing role which, on its own admission, it is not equipped to fulfil; shippers are best placed to buy gas from any sources.

The question of maximising supplies from domestic production is almost academic. This would be happening already, given the inevitability of rising prices, subject only to any technical restraints which may exist.

Perhaps it would be better overall to have a system in which large customers would agree in advance, gas year by gas year or for several gas years in succession, to be interrupted in whole or in part in an emergency, at a price which they would offer. Such "bids" would enable NGG and Ofgem to evaluate the willingness of customers to be interrupted in this manner and the costs of so doing.

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

We would not change NGG's role in any material way.

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

We have no further comments beyond those already made.

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

Question 6: What benefits would dynamic cash-out bring relative to the post emergency claims arrangements?

We are not in a position to answer Qs 5 and 6.

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?

This question seems to pre-suppose that industry does not already respond to the price signals which the market gives, but we do not see the evidence for this. On the contrary, the

market has responded well during both recent spells of severe weather, in January and December of 2010.

Arguably, as we have stated on several previous occasions, the one area of weakness evident in GB's gas market is in storage capacity, where the economics are difficult. More storage is almost certainly going to be needed in future and this would provide another means of prevention rather than cure.

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

A substantial barrier is outlined in our answer (ii) to Q.1 of Chapter 3 above. A second barrier is Public Service Obligations in some parts of Europe, hence the importance of full implementation of the EU's Third Package of liberalising measures (plus the completion of earlier packages) in all Member States.

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

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

Question 5: How could obligations be designed and enforced?

Given that we are not persuaded by Ofgem's proposals, it is very difficult to answer these three questions.

Question 6: What are the risks and potential unintended consequences associated with placing enhanced obligations on parties to ensure security of supply? Can these be overcome?

As indicated in answer to Q.2 of Chapter 3 above, there are substantial risks of financial difficulties for all but the largest shippers which therefore would lead to fewer shippers, a loss of liquidity and a less competitive market. This would be damaging and would undermine both security of supply and the economy's competitiveness.

It is increasingly difficult to be convinced that the proposed measures will have the desired effect and equally worrying that they could result in exactly the opposite.

Chapter 5

Question 1: Have we captured the feasible range of costs and benefits for inclusion in an impact assessment?

We make two broad comments, in line with those already contained above:

- i) there is not enough about preventing an emergency and too much emphasis on curing one;
- ii) the possible consequences of financial distress for shippers should be examined fully – fewer shippers, loss of liquidity, less competitive market etc.

Technical Annex

Question 1: Would it be appropriate to have multiple administrative VoLL settings for different customer groups? Why/ why not? How are VoLL estimates likely to vary between customer groups?

Question 2: For a customer group, how should we determine where in the range of estimates (i.e. VoLLmax, VoLLaverage or VoLLmin) we should apply a single administrative VoLL setting?

Question 3: Should the compensation payments to disconnected firm customers (based on VoLL) change with the duration of the interruption and the season in which the interruption occurs?

Question 4: What are the advantages and disadvantages of various methods for estimating VoLL?

Question 5: What sort of compensation arrangements should be used to apportion the costs of compensation between shippers?

For Qs 1 – 5, please refer to our answer to Q.2 of Chapter 3 above.

* * * * *