SCOTTISHPOWER
Energy Wholesale

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Dear Peter,

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

The following response is made on behalf of Scottish Power Energy Management Limited, gas shipper and storage operator, and part of the wider Iberdrola group. This response also reflects the perspectives of associated relevant undertakings i.e. Scottish Power Generation Limited, an electricity generator and gas customer, and Scottish Power Energy Retail Limited, a gas and electricity supplier.

Through our associated companies we are significant market players in gas security of supply. Our sister shipper, Iberdrola bring volumes of LNG into the country at the Isle of Grain. Many of our generation assets are gas fired and gas driven, as well as several CHP plants in the UK which consume significant quantities of gas and would be affected by firm load shedding. We also own and operate Hatfield Moor, the UK's first independently-owned gas storage facility.

Our generation plant played a significant role avoiding a gas emergency in the winter of 05/06, the closest we have come to date. Since then, as new sources of gas have become available and market flexibility has increased, the GB market has become one of the most stable and liquid energy markets in the world. The UK gas market is working, and we are concerned that any arrangements brought in to avoid or mitigate a gas emergency could affect the performance of the market, or at worst precipitate an emergency situation.

We appreciate the work Ofgem has done on security of supply and welcome this significant code review. Despite our initial scepticism regarding the powers associated with these reviews, we believe that the work programme developed for the Security of Supply review is focussing on areas that need to be addressed and can allow us to develop collaborative and consensual solutions to ensure the gas market continues to work and manage it when it doesn't.

We are pleased to have been involved in the seminars and workshops relating to the SCRs and were happy with the representative make-up of the participants, as well as the detailed output from each of the workshops, and we will continue to be involved throughout the entire process.

Currently we operate in a market which is characterised by flexibility and competition. We believe the liquid gas market works better by increasing opportunities and options as opposed to obligations.

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Some of the impetus for the SCR has come from the implementation of the 3rd package, and the move towards a single European gas market. We believe that the UK can provide a suitable model for Europe, seeing our own market as almost a “Europe in miniature”, particularly with our import dependency and source of flexible supplies. How the arrangements put in place in our market are applied across the member states should be a key consideration.

One of our key aims is to help protect the customer, from a safety perspective as well as recognising costs. We want to continue to offer value and choice, as well as protection. We need to continue to encourage gas connections – at exit as well as new entry points, and new sources of gas and the development of new gas storage and these arrangements should reflect this. National Grid is currently making significant returns for its shareholders and any further incentives and impacts of preparing for an emergency should be taken into account in setting the new price control.

We also believe that there are elements of handling an emergency that haven’t been fully dealt with in this or any other document, although there have been discussions there has been no significant output to change things. The priority user lists and handling of gas and electricity interactions, as well as knock-on consequences for industry and infrastructure need to be examined along with a range of safety considerations.

Of the options put forward, whilst we believe that there are so many variables that have not been quantified within them, we believe that shippers who bring gas to the market should be rewarded and agree with the principal that we can go significantly more deeply into a gas emergency before reverting to administered arrangements.

We do not believe that the introduction of obligations on shippers will accomplish anything. We prefer that users are allowed to use the flexibility they have within their own portfolios as they choose to avoid and come out of an emergency situation.

Our detailed responses to the questions raised in the initial consultation are attached below.

I hope you find these comments useful. Should you have any queries on the points raised, please feel free to contact us.

Yours sincerely,

Steve Gordon
Commercial and Regulation Manager (Gas)

SCOTTISHPOWER
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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 believe that there are potentially more combinations of the 7 elements that could work together other than the 3 identified. However, we agree that these 3 contain the basic elements of 3 distinct approaches and understand why the options have been presented in this manner. Each aspect needs to be considered in turn and choices in each will work better with other arrangements.

No single emergency, should one ever occur, will develop in exactly the same way or be most effectively handled in the same way. As well as different types of emergency and locational issues associated with these, the causes and speed of development of the emergency may be better handled by a different option.

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

We believe that none of the three options at the moment are sufficiently developed to make a decision on which would be most effective. Our main concerns are regarding how the dynamic cashout price might work, and whether it could lead to disproportionate costs and impact on credit arrangements and ratings. As a general principle, we favour keeping the market open for as long as possible to allow all market players to take the appropriate actions to prevent escalation of an emergency. No single option appears to be the ideal market-based solution, but we prefer an option which would reward shippers who were bringing gas to the market and not one which could potentially significantly punish even long shippers.

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

National Grid's role in preventing an emergency would be the same as in daily balancing – as a residual gas balancer effecting efficient system operation. It has long been understood that this reverts to command and control following the declaration of an emergency. However, there is a question over when this should come into effect – possibly after the firm load shedding process. We see little appetite from National Grid to act alone as the sole purchaser of gas in the market, nor do we consider that they have the necessary skills in house to perform such a function.

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

We do not believe that too much additional complexity is created by efficient cost allocation, however we would not want these considerations to hamper the speed of response once a network emergency is in progress. We agree that barriers to entry for smaller participants should be overcome, but we do not see the emergency arrangements having any discernable effect on smaller participants entering the market.

We also don't necessarily recognise as smear as a positive but believe that costs associated with dealing with an emergency should be socialised to some extent. If costs are to be socialised/smeared among users then they must be kept to a minimum.

Unfortunately, we have a number of pros and cons identified for each of the options. However, whilst we largely agree with pros and cons associated with the options, we would not necessarily give equal weight to each of these.

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

There are safety case implications associated with each aspect of the options, but these are already in place and any additional responsibilities will impact on this. We believe that some tweaking of the safety case will be required with any additional role for national grid during or surrounding an emergency.

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

It will allow quicker and possibly more effective response during the emergency, and could help avoid unfortunate credit-related consequences.

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 should reduce the possibility for perverse incentives on market participants to hold back gas for a higher price to materialise. This particularly applies when the NEC no longer has the ability to maximise supplies. However, depending on which combination of options was introduced and how quickly the emergency deepened, there would be a risk in holding back gas from the market and that uncertainty could ensure that supplies are brought to the market as quickly as possible.

There are also credit issues to consider which could effectively halt trading between participating entities.

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

There are existing barriers to attracting gas into the country relating to the availability and the costs of capacity. One such barrier lies with the costs of obtaining entry capacity, which is significantly more expensive for people who bring new gas into the country than those operating with existing contracts at entry points where less gas in coming in than in previous years. Effectively a cross-subsidy exists, where despite paying a high price step for obtaining incremental capacity, these suppliers are also expected to pay an additional smearing charge, the TO commodity charge, because of under-recovery of revenue at other entry points where capacity is cheaply available. We believe this could be remedied by exempting entry flows at terminals where these high prices have already been paid from the smear, and we would like to raise a network code modification proposal to make that effective and enhance security of supply, ahead of an emergency.

No doubt these charges pale into insignificance when an actual emergency has occurred. Conditions must be right to attract maximum gas flows into the country. In certain circumstances, the gas deficit will exist in neighbouring markets also, and in the absence of regional co-operation envisaged by the single European market for gas, there is nothing to compel suppliers to bring gas to the UK or to avoid foreign markets from offering a UK price plus arrangement to these providers.

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

We believe that introducing obligations on market participants could be counter-productive. Our preference would be for offering choice in utilising the flexibility of market players in the form of quota disconnections and interruptible services. Obligations to secure additional gas could have a detrimental effect on market operation and may not additionally lead to new volumes being made available in an emergency. Currently storage is used in a variety of ways to provide flexibility for the market, and to set some aside for an emergency could significantly decrease this. Also, we believe that there will be price increases associated with these spares which could lead to higher costs for consumers.

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

Any additional obligations could be placed on National Grid as a result of their role in an emergency being changed.

We do not believe in obligations on other market participants. This would adversely affect competition and we prefer using and encouraging participant flexibility and voluntary arrangements.

Question 5: How could obligations be designed and enforced?

It is likely that the safety case would be affected (as above).

Alternative obligations can be implemented through changing the Uniform Network code arrangements for Emergencies, and these can carry financial consequences. As well as this, licence conditions could be added or amended to reflect any new obligations.

Ofgem may require additional statutory powers to implement the arrangements brought in through the SCR process, and there should be some negotiation with the HSE when considering the safety implications of any/alternative changes.

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?

Risks are increasing costs for all parties with obligations, but these costs should be kept to a minimum, with some additional obligations on National Grid and allowing other market participants

CHAPTER 5

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

We are happy that a wide range of costs and benefits have been captured and additional information could come to light in the Impact Assessment consultation process.

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?

Different industry participants value their gas in different ways, which is why it is important to understand the implication of loss of gas to each sector, and be aware of the energy interactions. VoLL may prove a useful tool or could end up being a target in an emergency situation.

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?

The greatest difficulty would be in determining the level of VoLL for industrial customers, because we believe this is where the greatest variance occurs. We do have some signals from the interruptible regime, but at present without further consultation it is difficult to know if we can apply a range of VoLL or where the single administrative setting should be.

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?

The consequences would potentially be different at different times of the year for certain groups of customers, but this should be taken into account in the light of the need to avoid precipitating an emergency at any time of the year.

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

We have a concern over a pre-determined VoLL, in terms of how that value will be used to determine shipper behaviour, with quantities of gas possible being deemed to potentially have that value. However, there are also clear advantages in setting costs and provisions for an emergency from awareness of this figure. The central importance of VoLL should not be a distraction in the principle task of avoiding a gas emergency, and we would prefer that it was set as simply as possible but with this principle in mind.

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

We support the principle of compensation for disconnected customers who rely on a firm gas supply, but we would prefer to see some sort of cap on liabilities for shippers, given the potential credit consequences arising. This needs further discussion and should form an essential part of any Impact assessment.

We hope to be able to provide additional information as the consultation process develops, but at any time please feel free to discuss any of the points raised in this response.