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Dear Peter

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

Thank you for the opportunity to comment in response to this consultation document. The following views are offered on behalf of Shell Energy Europe Ltd (SEEL), Shell's pan-European gas, power and CO2 trading arm, which through Shell Gas Direct (SGD) Ltd, is a GB gas shipper and supplier.

This response is not confidential and may be placed on your website. Please see Appendix 1 for detailed answers to the questions contained in the document.

This consultation should be set against the backdrop of the undeniable success of the GB gas market in delivering security of supply. There has not been a Gas Deficit Emergency (GDE) and over recent winters the gas market has proved robust in responding to record demand levels. Our view remains that the market has and will continue to deliver investment and reliable energy to GB.

To the extent that the current incentives on market participants remain of an optimum nature, it is proper for industry to examine the current arrangements, if only to confirm that they remain appropriate. In that regard, we note the central role in discussions to date for the potential use of a dynamic cash-out price and/or VOLL. Both proposals may have some degree of theoretical attractiveness but some practical issues have been identified, namely in relation to arrangements in other nearby markets, the issue of escalating credit requirements and the subsequent implications for systemic risk and competition.

An early view might suggest that any moves in these areas should be avoided due to the widespread and unquantifiable nature of the unintended consequences.

The emphasis on these areas may, however, help to explain why the debate to date has been in relation to sharpening financial incentives on shippers and suppliers. It is not clear why this should be the case, especially given that the current drafting of the Energy Bill refers to the creation of financial incentives for shippers **or** gas transporters.

I trust that you find our response helpful. Please do not hesitate to contact me should you have any questions or require further clarification.

Yours sincerely

Amrik Bal
**Regulatory and Commercial Affairs Manager, Shell Energy Europe Ltd**

## Appendix 1

**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?**

As a result of discussions in the workshops, two potential options that may be worthy of further consideration involve a restoration of interruption rights available prior to UNC Mod 90 and/or a national top-up regime.

We do not necessarily support either option but for completeness sake, it might prove useful to consider the costs, benefits and degree of distortionary effects of each alongside those contained in the consultation document.

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

Directionally, Option 1 is the more attractive of the options as it proposes a continuation of shipper-to-shipper trading, market based balancing and no role for the monopoly transporter in procuring gas. However, it is too early to say that we support this or any option at present given that each is:

- not sufficiently developed enough;
- lack the requisite clarity; or
- signal directional moves that are difficult to support.

Moreover, each option has significant uncertainties, if not impracticalities, at least at present. The potential use of VOLL is a case in point. Clearly, some parts of the market will value continued supply more than others. However, to ask individual customers to indicate the value of their loss of supply would appear impractical; if nothing else, it may change from day-to-day, time of year, etc.

As pointed out in the workshops, the VOLL calculation is an exercise that was in effect carried out as part of the DN interruptions reforms, where customers were asked, albeit for capacity management purposes, to indicate the value they placed on having to cease to gas consumption. The low levels of customer participation were perhaps reflective of the difficulties or unwillingness for those without back-up fuel to calculate this figure. It is not clear why it would be any different in the context of the current discussions?

As such, VOLL could become an arbitrary 'higher' figure that sets a cap on market derived cash-out prices. In that sense, it is not clear to what degree the proposal changes the frozen or static nature of the current arrangements? Moreover, Ofgem will be aware of the concerns expressed in the workshops of the potential gaming dangers associated with an ex-ante indication of the VOLL figure.

Other problems associated with each option include the systemic credit risk of dynamic cash-out prices or the interaction with nearby European markets are picked up elsewhere in our response.

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

Some aspects of the proposals suggest a role for NGG to procure gas. This is not a directional move we would support as we believe that involvement in the commodity market should be left to shippers. Moreover, aside from putting shippers in the position of having their liabilities managed by another party, it is not obvious:

- how the transporter, with no experience of buying gas on the international markets, will be any better placed than shippers to procure gas?;and
- that this might not distort shipper behaviour ahead of an emergency especially with an ex-ante indication of VOLL?

An issue that has not been discussed to any great degree is the specific one of maintaining customer emergency contact details. At present, the responsibility for keeping this information rests with shippers. However, in the transporter-shipper-supplier-customer chain, the two constants are the GT and the consumer.

If the (correct) aim is to avoid getting into an emergency, it would seem appropriate to consider whether a responsibility for NGG and other GTs top keep these details - possibly via shippers sub-contracting their current legal obligations - would an improvement on the current situation.

**Question 4: Do you have any comments on our initial assessment of the pros and cons associated with each option?**
At the present time, we do not believe that Ofgem's proposals are worked up in sufficient detail for us to fully understand how they would operate.

That said, in signalling a broad direction of travel, we would suggest that the case for moving away from market based mechanisms should be the key test for any proposal.

**Question 5: Are there any safety case implications associated with each option?**
We are not in a position to add to the comments in the consultation document.

**Question 6: What benefits would dynamic cash-out bring relative to the post emergency claims arrangements?**
As we understand it, the current post emergency claims process does not provide an absolute guarantee of the price to be received for gas. To the extent that this correct, a dynamic cash-out price should provide more certainty, so it would seem reasonable to conclude that this would be an improvement on the current arrangements.

That said, any improvement via a dynamic cash-out price might be overwhelmed by the impact of interactions with European arrangements and/or increased credit requirements.

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 would point out that over the last two winters where record demand levels were recorded, the gas market has adequately demonstrated that it will respond to:

a) With-in day Gas Balancing Alerts (GBAs); and
b) Price signals, both in terms of an increase in supplies and demand side response.

The issue of responding to sharper price signals therefore becomes a non-issue. However, there are related issues such as credit or the arrangements in neighbouring markets that may have an impact.

**Question 2: What are the likely barriers to attracting gas imports during a GDE? Could these barriers be overcome?**
The issue of corresponding cash-out arrangements in neighbouring markets has already been made. That said, another aspect of such arrangements is the nature and extent of Public Service Obligations in other markets.

The issue of the current emergency claims process, referred to previously, is another relevant issue as it contributes to price uncertainty.

**Question 3: Do you think that the risks associated with sharpening price signals make it necessary to apply additional obligations on relevant parties?**
On the assumption that the risks associated with sharpening price signals are eventually deemed to be too great, it is vital to recognize that obligations of any type imply costs. As such, the principle of cost targeting being reflected in any new arrangements becomes an important consideration.

In Ofgem's workshops, mention was made of the role that could be played by Industrial and Commercial (I&C) customers, the overwhelming majority of whom are not covered by the priority arrangements, in offering demand-side response. We imagine that such customers would: want to be adequately recompensed for providing such a service; and be concerned if the subsequent costs were socialised (if this resulted in their picking up some of the SO's costs).

**Question 4: If enhanced obligations were applied, to whom should they be applied and why?**
**Question 5: How could obligations be designed and enforced?**
In answering these questions, we would like to make clear that no convincing case for enhanced obligations has yet been made. However, it is reasonable to assume that two principles need to be kept in mind in considering any moves in the direction of obligations:

- cost targeting; and
- reducing the potential distortions in relation to the competitive market.

Placing (the costs of) obligations on the competitive activities of shipping and supply would seem counterintuitive. Given the highly unlikely prospect of a GDE, a more practical and cost-effective solution would be an obligation on NGG, with costs recovered from short shippers.

**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 we say in response to Q3, obligations imply costs. In that context, the most obvious concerns would be in relation to:

- whether the level of costs acted as a barrier to entry or reduced the existing number of market participants;
- competition was further distorted if cost recovery was not accurately targeted; and
- limitations on how shippers could meet their 'obligations', eg. obligations to have physical gas contractual arrangements, impacted on:
  - the efficiency of shippers' portfolio management and balancing options; and
  - a reduction in market liquidity.