Our date	Our reference	Administrative officer
2011-02-22	STUK response SoS SCR	Shelley Rouse

Your date	Your reference
2011-02-22	02/11

Office of Gas and Electricity Markets
Attn.: Peter Sherry
9 Millbank
SW1P 3GE London
United Kingdom

Dear Peter,

RE: Gas Security of Supply Significant Code Review – Initial consultation

Thank you for the opportunity to comment on the above consultation.
As a major importer of Natural Gas to the UK, Statoil is a great interest in the operation of the GB gas market and the future security of supply.

Statoil welcomed this holistic review of the emergency arrangements believing that this is the best way to identify any potential improvements to the regime. However, having considered the consultation document and by being part of the significant code review working groups (as a producer representative), Statoil remains unconvinced that there is a real case for significant change to the current emergency regime.

The winter of 2010/11 saw the UK experience its coldest winter for many years with record demand levels being reached. The gas market arrangements succeed in sustaining supplies throughout the period and keeping natural gas prices at a reasonable level. Gas Balancing Alerts were issued and succeeded in bringing the required volumes of gas supply and demandside response to the market without the need for emergency procedures being used.

With this in mind Statoil find it difficult to offer support to any of the options proposed in the consultation document, and would first like an understanding of what the required level of security is deemed to be. Also during the working group sessions, although useful debate was had there was little time to fully understand the consequences of implementing the suggested options or assess the additional benefits against the status quo. We acknowledge that the consultation points to key drivers of the review as being shortcomings in the current incentives to avoid an emergency and limit its duration, the lack of incentives to encourage gas supplies to the UK and the lack of compensation for firm customers that are curtailed during an emergency, but without clearly understanding the extent to which these elements of the regime are hoped to be improved by the proposed changes it is difficult to assess the most suitable solution.

Statoil believe that recognition should be given to the different types of emergency that could occur. The concept of a smouldering and sudden crisis have been recognised in publications by BERR (Upstream Oil and Gas industry crisis management briefing), and is something that should be considered as part of this review.

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Care should also be taken to ensure that the requirements of the EU third energy package and the gas safety regulations are fully considered as part of any proposed change particularly with regard to interactions with continental markets.

The concept of unfreezing the emergency cashout price has been discussed by the industry on various occasions with UNC modification 0149, which consider unfreezing the cashout price being proposed and later rejected in 2007.

The concerns expressed surrounding this proposed amendment to the regime remain unchanged.

Statoil believe that during stage 2 of an emergency when the market has essentially failed to deliver, the setting of cashout prices on a dynamic basis is unlikely to deliver any additional gas to the UK market in what is essentially a command and control situation. It is unclear that a dynamic cashout price would encourage additional continental supplies to the UK, particularly if the emergency was caused by an issue which did not impact the UK in isolation e.g. an extended period of cold weather. The influence that this price would have on attracting LNG cargoes to the UK is also uncertain as global factors would also need to be considered, the main issue of course being the location of the cargo in relation to the UK and likelihood of a sustained high gas price.

Even is the dynamic cashout price is to be capped (potentially at a predetermined Value of Lost Load) there is the potential that the dynamic price will be open to gaming with the market price being pushed to levels that exceed the under lying fundamentals. It could also be suggested that imports could be delayed until the cashout cap is reached as market players attempt to achieve the maximum value for their gas supplies. There is also the risk that arrangements put in place by other European players may provide stronger incentives than those set by the UK, there is therefore no guarantee that a regime which places a high burden on UK market participants will encourage any further volumes of gas to the UK during an emergency.

A further area that needs to be considered when looking at the introduction of a dynamic cashout price is that of credit and shippers ability (particularly small shippers) to manage their positions at times of extremely high prices. The potential multi-million pound exposure that shippers could face against the backdrop of rapidly escalating cashout prices would without doubt leave many shippers facing financial difficulty. The knock on effects of shippers leaving the market and their imbalance debt being passed to the remaining players would have dramatic financial consequences for all marker participants, which could lead to complete market failure.

The concept of VoLL, although not known by this terminology, is something that currently recognised and used by shippers and consumers particularly when negotiating gas supply contract terms. Many shippers offer their customers the ability to sell gas back to the market when the gas price reaches a level at which it is uneconomical for them to continue consuming (therefore assessing their own VoLL), at anytime and not just in a gas supply emergency.

Following the implementation of UNC modification 090, Revised DN Interruption Arrangements, those consumers that wished to enter into contracts for interruption were asked to identify the value of their interruptible gas supplies. Although this was as a result of a change to the capacity interruption regime (the reason for interruption is not a consideration when a consumer is faced with a loss of supply) and considered the value placed on interruptible volumes of supply, the results of this tendering exercise should be carefully considered when further looking at VoLL and consumer appetite for such requirements.

Whilst recognising that VoLL can be a consideration when looking at the emergency arrangements and a consumer's willingness to respond to market signals, Statoil believe that there should be a clear distinction between VoLL and compensation. The two do not need to be linked and Statoil do not agree with the consultation proposal that the compensation for firm customer disconnection should be automatically linked to an administered VoLL.

VoLL is extremely difficult to calculate, even between similar classes of consumer. It was acknowledged in the working groups that not only do different customers value lost load differently, but that also different tranches of supply to a single offtake were likely to have a different value associated with it.
Ofgem have suggested initial estimates put VoLL at between £2 and £52 per therm, although many I&C consumers have indicated that their true VoLL would be significantly higher potentially in the region of £000's per therm.

In this context is in unlikely that a 'one size fits all' VoLL will be appropriate, and determining different levels of VoLL for different classes of consumer will create confusion adding complexity to the regime at a point in time when a clear understanding of the arrangements and the consequences of actions is vital.

Although this review focuses primarily on Gas Deficit Emergencies and a loss of gas supply, the interactions between the system capacity and commodity regimes should not be understated. It is likely that when a gas deficit emergency is declared that gas supply to the UK would be restored before many isolated areas of the network are reinstated, meaning that consumers would be without a gas supply for a period longer than the actual supply shortage. This potential shift in liabilities needs to be considered in conjunction with any compensation regime to ensure that all parties are treated fairly and that the regime does not place an unnecessary financial burden on a particular type of market participant.

Statoil are cautious to recommend any solutions at this stage and believes that there is still a lot of discussion and debate to be had in this area. We look forward to further contributing to industry debate on security of supply by continuing our participation in the industry SCR working group and working with Ofgem to fully understand the extent of its concerns.

If you have questions, please contact me on the below number.

Kind regards

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Shelley Rouse
UK Regulatory Affairs Advisor
Statoil (UK) Ltd

*please note that due to electronic transfer this letter has not been signed