



Anna Barker
Ofgem
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Dear Anna,

Gas Security of Supply Significant Code Review - Draft Policy Decision

We welcome the opportunity to respond to this consultation and appreciate the effort that has gone into the consultative process to this point, particularly the more open and inclusive aspects of the workshops and seminars that have been held as part of the second phase of this SCR.

The following response is made on behalf of ScottishPower, part of the Iberdrola Group, as a Gas Shipper, Storage Operator, CCGT generator and major gas customer. When taken in conjunction with our sister Shipper, Iberdrola Generacion S.A.U., which brings significant volumes of LNG into the GB market at Isle of Grain, we are significant market players and contributors to gas security of supply.

Clearly gas security of supply is an issue that demands the closest of scrutiny and that should be the subject of ongoing review, all the more so as we now look ahead to the important future role for gas-fired generation as a significant element of the generation mix, both in its own right but particularly as the flexible generation capacity required to support intermittent renewables. To this point we would continue to contend that the current competitive market arrangements have provided ample security of supply in sometimes trying winter conditions in recent years but we fully agree that complacency should be guarded against and that past success of itself need not guarantee similar success for the future.

But such scrutiny and review requires to be undertaken against the relevant market backdrop and in the context of both current experience and future projections. There are many ingredients in the mix that goes to make up gas security of supply and we recognise that the diminishing availability of indigenous supplies from the UKCS and the corresponding increased import dependence are central triggers in this review process. That having been said we now have greater diversity of supply sources than ever before, including our increased LNG capacity, together with increased investment in robust and enhanced gas infrastructure, including our increased interconnection with Continental Europe, with much of that having been delivered on the back of market led investment. Looking ahead there is also the realistic potential of access to abundant alternative sources of supply, including shale gas so we do not regard the outlook as bleak.

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However we are concerned that there has not been a comprehensive consideration of all of the aspects at play and nor are we convinced that the case for change has yet been made. To that extent we would have reservations in becoming immersed in a detailed consideration of “solutions” which we believe may be based on incomplete analysis and for that reason we have chosen at this time not to respond to the individual questions posed in your consultation. Rather we would prefer to emphasise and reiterate what we believe to be the key messages and key considerations following on from this review: -

Timing

- We would urge Ofgem to reconsider the intention of implementing what by its own admission would only be a “partial” solution, where many factors inevitably have not been taken into account. We believe that the SCR ethos should include the objective of providing a holistic solution and if, as appears to be your contention here, that further interventions are most likely to be required, then it would be prudent for such options to be identified and fully appraised, including any interactions with one another and with your current proposals. This would hopefully ensure that an optimum and cost effective solution is adopted, whilst also minimising the likelihood of unintended consequences. As you recognise in Section 5.6 of your draft policy decision the introduction of such enhanced obligations or other interventions raise detailed design issues and the risks and consequences associated with their implementation must be looked at in the round;
- At the moment we are going through a phase of almost unprecedented change on a European scale as we look to develop Framework Guidelines and Network Codes to deliver a more integrated Europe wide gas market. To rush to make fundamental changes to our own arrangements at this time ahead of a full understanding of how such changes are to work in practice, the benefits that they may bring or the impacts that they are to have on levels of security of supply, would be inappropriate, potentially unnecessary and may even lead to the adoption of arrangements that may only have to be unravelled at some future date;
- The impacts of the outcome of Electricity Market Reform and the efficiencies that may be derived from the rollout of smart metering have yet to be identified or assessed. Both of these issues have the capacity to change gas demand patterns significantly in the near time future;
- These levels of regulatory uncertainty can only have an adverse impact on the investment environment. It would be preferable to attempt to identify and implement comprehensive reform, which has at least attempted to have taken account of all relevant factors at the relevant time;

Further Non-Market Based Interventions

- The prospect of further non-market based interventions such as Public Service Obligations may only serve to distort and jeopardise existing market arrangements that have successfully delivered investment to date. For example whilst market conditions currently may not be particularly conducive to new storage investment, nonetheless the imposition of some measure of storage related PSO would only undermine such existing investments. In addition, whereas the availability of gas in storage may well provide a measure of security of supply, this would be a hugely expensive option to provide a safeguard for what may be an extremely unlikely eventuality, to the point where it may be entirely disproportionate. Perversely the reliance on such storage may actually only help precipitate such an emergency where parties with access to such gas in storage withhold that gas in anticipation of the heightened prices that would accompany such an emergency;

Cash out and VoLL Assessment

- It is difficult to envisage how cash out reform of the kind envisaged may contribute towards greater security of supply and in particular how it is likely to achieve the first objective of the Review which is to “minimise the likelihood of a Gas Deficiency Emergency (GDE) occurring by encouraging gas shippers and suppliers to take out sufficient investment to ensure gas security of supply”. The reforms appear predicated on Shippers being able to respond which may not necessarily always be the case depending on the nature of the emergency and whether alternative sources of gas were actually available. Moreover we share the view that the existence of the £20/therm cap would only serve to act as a price target, resulting in a rapid price escalation in the event of an emergency and hindering the securing of contracts for adequate volumes of interruptible supply at commercially acceptable terms;
- The assessment of VoLL at £20/therm and its linkage to the cash out arrangements and customer compensation results in a package which appears to lack credibility. Whereas the methodology adopted to calculate “domestic” VoLL appears reasonable in the circumstances, its subsequent application to determine cash out or compensation levels for such as industrial customers seems disproportionate and results in values that are so far in excess of the highest market prices experienced as to give rise to concerns of “over-compensation”. Consequently the adverse impact that this may have on smaller players and their ability to secure adequate credit facilities may well have unintended impacts on competition in the market by potentially hastening the voluntary exit from the market of such smaller players and/or deterring new market entrants. Indeed during the course of a Gas Deficit Emergency it may even have the effect of exacerbating the situation by accelerating the insolvency of such smaller players.

Market Based Intervention Options

- Initial consideration of some of the other market based options point us towards a view that is shared amongst much of the Shipper community that Demand Side Reduction measures, if appropriately designed, may be one such mechanism with the potential to enhance certainty in the emergency arrangements, whilst at the same time having the minimum impact on the existing market arrangements that could be allowed to continue to operate for as long as possible.
- To this point there is no real evidence that there is much of an appetite for parties to conclude interruptible contracts with Shippers that would provide adequate confidence that security of supply could be achieved. However, were such contractual arrangements to be administered centrally via National Grid, perhaps on a tender or auction basis, then this may give such arrangements greater substance and would not lock customers into longer term contracts with Shippers. Furthermore, it would also allow for a more accurate assessment of the levels of interruptible volume that would be required to address the security of supply requirements as National Grid would have greater access to the necessary data on a real time basis than would individual Shippers, thus providing a more optimal and comprehensive solution rather than the provision of anything more piecemeal from across the whole Shipper community.

I hope you find these comments useful. Should you wish to discuss any of these points further then please do not hesitate to contact me.

Yours sincerely,

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