

Thomas Farmer,  
Economist, GB Markets,  
Ofgem,  
9 Millbank,  
London, SW1P 3GE.

6th Floor East  
Portland House  
Bressenden Place  
LONDON SW1E 5BH  
Tel: +44 (0)20 7802 2400  
Fax: +44 (0)20 7802 2401  
Email: [info@oilandgasuk.co.uk](mailto:info@oilandgasuk.co.uk)  
Website: [www.oilandgasuk.co.uk](http://www.oilandgasuk.co.uk)

23<sup>rd</sup> October 2012.

Dear Thomas,

### **Gas Security of Supply: Significant Code Review – Proposed Final Decision**

Thank you for the opportunity to reply to Ofgem’s Proposed Final Decision, ref. 111/12, which was published on 31<sup>st</sup> July 2012. Oil & Gas UK has taken part in various seminars and workshops from the very beginning of this process in October 2010 and has responded to previous consultations by Ofgem. We are, therefore, taking this opportunity not only to reply to the Proposed Final Decision, but also to re-emphasise some of the points which we have made in the past and which, in our opinion, remain central to a satisfactory resolution of this whole matter.

#### **Previous Submissions by Oil & Gas UK**

We begin with three short extracts from our response to Ofgem’s consultation, ref. 02/11, during early 2011 and two others from our letter of 20<sup>th</sup> February 2012 to Anna Barker of Ofgem who had been leading the work on the SCR.

1. As one of a number of introductory comments regarding consultation 02/11, we wrote this:

*“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.”*

2. In answer to Q.2 of Chapter 3, *“Of the three options presented, which do you prefer? Why?”*, we wrote as follows:

*“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.*

.....

*“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.”*

3. And to Q.1 of Chapter 5, “Have we captured the feasible range of costs and benefits for inclusion in an impact assessment?”, we replied:

*“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.”*

4. The first extract from our letter of 20<sup>th</sup> February 2012 is this:

*“Ofgem has concentrated on what would happen in GB in the event of a gas emergency developing and, in particular, the cash-out price ... While a review of the cash-out price may well have its merits, we firmly believe that it is a mistake to look at this matter in isolation.*

*“As well as other measures which may be equally effective or better, such as demand side response / interruption, security of supply is best considered from an overall perspective. Ofgem has been commissioned by DECC to look at ‘further interventions’ with respect to security of supply. It surely has to make sense to combine these into a single review and not take action in a piecemeal fashion, particularly when some of the assumptions about infrastructure reliability contained in the Impact Assessment for the SCR look to be highly questionable.”*

5. And a second extract from that letter:

*“We therefore urge Ofgem to reconsider its current course of action; by concentrating on one measure, the value of lost load (VoLL) in a GDE, Ofgem risks taking too narrow a perspective of what is a much broader subject. We are not convinced that £20/therm will necessarily produce more gas than, say, £2/therm. Furthermore, a VoLL of £20/therm has its own risks: creating an expectation that this is what the cash-out price will be; threatening companies’ liquidity and so squeezing the number of shippers; and, ultimately, damaging the very market which has served GB so well.”*

### **Ofgem Proposed Final Decision**

Turning now to Ofgem’s Proposed Final Decision and further consultation, ref 111/12, we remain unconvinced by Ofgem’s reasoning and are profoundly concerned that the proposed final decision carries with it risks to both security of supply and the proper functioning of GB’s gas market, neither of which would be a desirable outcome.

- i) We continue to regard the prevention of an emergency as the most important requirement of all. We do not believe that Ofgem’s proposal addresses prevention sufficiently, nor do we believe that the proposal will have the results Ofgem intends.
- ii) There is a material risk that a VoLL of £20/therm will simply become a target price.
- iii) There is an attendant risk that this VoLL will be “exported” to continental Europe, thereby removing any incentive to ship available gas to GB when most required.
- iv) The financial distress that £20/therm will cause to shippers in an emergency has not been considered adequately. It is likely to lead to fewer shippers (and predominantly larger ones), reduced liquidity and, ultimately, permanent damage to the market for gas which has served GB so well.

- v) In turn, this will tend to reduce security of supply and increase prices for consumers. There will also be adverse knock-on effects for the electricity market.
- vi) We still remain convinced that security of supply should be looked at in its totality, so that this proposal and possible "further interventions" (Ofgem's separate work for DECC) are considered together.

Nonetheless, when considering this proposal on its own, Oil & Gas UK supports the work being done by the Gas Forum. It would be preferable for National Grid to contract in advance for interruptible capacity with major consumers, rather than individual shippers attempting to do so. Likewise there should be no pre-determined VoLL. We believe that this approach has a greater chance of success and would enable National Grid, as system operator, to play a crucial role in preventing an emergency developing, instead of managing one after it had developed.

We trust that these views will be taken into consideration by Ofgem in reaching a final decision and we remain available to discuss them further, should you so wish. We are also copying this letter to Edmund Hosker and Michael Rutter of DECC.

Yours sincerely,

A handwritten signature in black ink, appearing to read "D. N. Odling", with a horizontal line underneath.

David Odling,  
Energy Policy Manager.

Cc: Edmund Hosker, DECC  
Michael Rutter, DECC.