4 July 2012

Gas Generation Call for Evidence
Area 4E, 3 Whitehall Place
London SW1A 2AW

Re: A call for evidence on the role of gas in the electricity market

The Gas Storage Operators Group (GSOG) welcomes the opportunity to provide its views on the role of gas in the electricity market. GSOG supports the Government's statement that gas will play a vital role in the ongoing decarbonisation of the GB energy market, and the fact that the electricity and gas markets, as well as requirements for heat, are highly interrelated and that Government policies must take account of these interactions.

The GSOG is a trade association which was formed in May 2006 within SBGI Utility Networks. The Group has sixteen members and comprises of almost all the active participants in the GB Gas Storage Market and as such represents a wide range of interests. The Group includes both established operators and developers of new storage projects, large multinational companies and smaller private ventures. This response sets out the majority of GSOG member's views on issues that DECC should take into consideration as it further develops its Gas Strategy. The signatories to this submission are detailed in Appendix A.

Gas has an important role in the UK energy mix

GSOG endorses DECC's view that gas plays a vital role in the GB energy mix. Further, we agree that gas, and electricity generated from gas, will continue to play a fundamental role in supplying GB's energy and heat requirements for at least the next two decades.

However, GSOG would encourage the Government to recognise the ambitiousness of its decarbonisation and heat targets, and that gas (particularly conventional gas) is likely to be required up to 2050 and beyond. This cannot be achieved without developing gas CCS and ensuring there is suitable economic support in place for its deployment.

If the Government wants to encourage market participants to make the investments necessary to ensure secure, reliable and cost-effective gas supplies in the medium and longer term, it is fundamentally important that investors have a clear understanding of

the likely time horizon for the required investments. For example, a storage investment decision will generally be based on an asset life of 30 to 40 years.

Given the above, GSOG would urge the Government to provide greater certainty about the role gas is to play in the GB energy mix until at least 2050.

CCGTs need physical gas – more storage capacity is crucial

The GSOG agrees that GB has benefited from having one of the largest, and most competitive, liquid and transparent gas markets in Europe. We also agree that the Government is correct in its view that maintaining flexible and diverse sources of gas supply will become increasingly essential as GB moves to an extremely high level of import dependency; a key challenge for the Government must be to ensure that gas supplies will be available to meet demand in a secure and affordable way.

The GSOG also agrees that increased dependence on gas generation is likely to increase the need for flexibility in the gas network. National Grid themselves see the potential for within day variations in gas demand approaching 100mcm as a result of 30GW of wind generation on the system (NG Ten Year Statement - Dec 2011). Such supply volatility could occur at any time of year and calls for flexible, responsive gas storage capacity.

In addition, to mitigate against the increasing price spike risk resulting from exposure to the global gas market, GSOG believes that the GB market needs to replace 'locally sourced' flexible gas. The GSOG believes that gas storage is the obvious substitute for several compelling reasons including that; it delivers physical gas, it is locationally close to the market, is subject to third party access arrangements and is more open than other GB markets, it operates within a transparent market and usage and availability are monitored and publicly available, it provides delivery support for other source of supply, it works with market signals (i.e. strategic withholding/reserving not required for security of supply) and importantly for the physical security of supply, it is available to be called upon by NGG in a Gas Emergency.

Further import capacity would not provide equivalent benefits in terms of GB gas supply security, since capacity does not equal physical gas and the UK would still be exposed to winter spot price risk

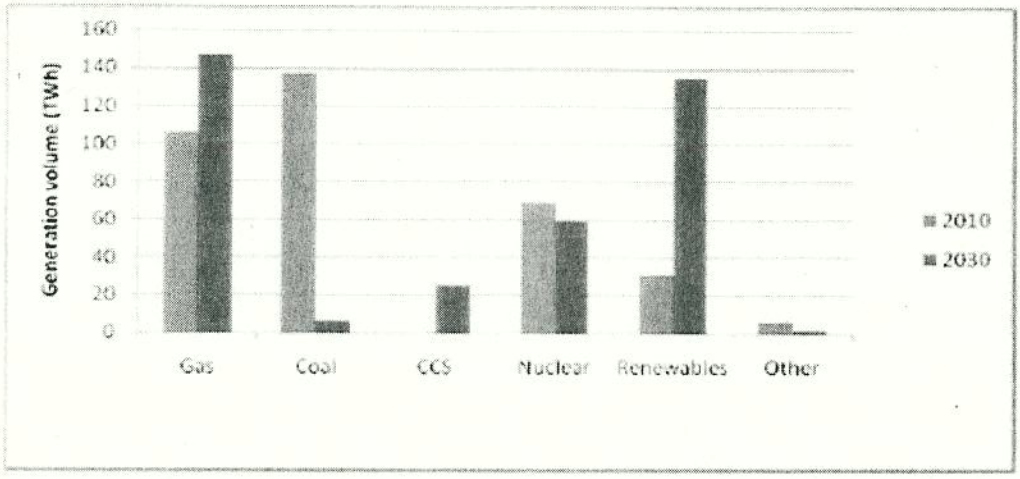
Gas storage is one of the most cost-effective means of dealing with both supply side and demand side volatility. Gas storage can address potential supply side imbalances (i.e. allowing GB to store imported gas). Similarly, storage (as opposed to other forms of flexibility) can be profiled to deliver gas during periods of high demand. The flexibility of gas storage therefore provides both greater physical security to the system and reduces price volatility.

In the current economic environment, current spreads (summer-winter price differentials), price volatility levels, as well as other challenges (such as regulatory uncertainty and networking charging volatility) make investment challenging. GSOG does not agree that current SCR proposals by Ofgem in relation to sharpening price signals will deliver investment in storage infrastructure.

We believe that the degree of uncertainty surrounding the economic modelling, coupled with the degree of uncertainty surrounding Shipper behaviour post the introduction of the proposed changes to the cash-out arrangements, does not provide enough certainty that the security of supply concerns will be addressed. We are of the firm belief that a significant gap in the emergency arrangements will remain post the introduction of the proposed changes to the cash-out arrangements and that this gap is best bridged by increasing the amount of storage available to the market at times of stress.

GSOG considers that further support will need to be provided if the Government wants a sufficient volume of storage capacity to be delivered to support the requirements of the GB gas market stemming from increased generation of electricity from gas and import dependency. The importance of gas to GB electricity generation in the near term to medium term is highlighted in the DECC baseline generation mix, as detailed in its Generation Impact Assessment (July 2011), where it states that between 2010 and 2030, the share of renewable generation is expected to increase from 9% to 38% but gas-fired generation is also expected to increase from 30% to 40%.

Baseline generation mix (TWh)



Source: DECC Impact Assessment July 2011

Policy co-ordination and timing

GSOG agrees that the complex interconnections between the electricity and gas markets, as well as requirements for heat and decarbonisation of the energy sector pose a number of policy challenges. Given this, we are supportive of DECC's efforts to seek views on its gas strategy and the need to align this work with the EMR, Heat Strategy and Ofgem's report on security of supply.

It is important that the Government's proposed policy responses for these strategies are mutually consistent. This will provide the market with the necessary certainty on which to build investment cases, and prevent potential distortions and inefficiencies.

However if the market is to deliver the necessary investments by 2020, it is also important that the Government recognises the need to provide a clear direction on its vision for the energy market, and the extent and scope of any support it intends to provide on a timely basis.

Although there is almost 10bcm of gas storage projects with planning consent which would allow the commencement of construction (double the current GB gas storage capacity), the GSOG would also like to make DECC aware that gas storage development is not a quick fix; storage facilities can take in excess of six years to construct. A review concluding that the GB energy market needs more gas storage will need to ensure detailed policy arrangements within the next 12 months if additional capacity is to be delivered by 2020 when import dependency will be around the 70% mark. Investment in gas storage would not only provide flexible and secure fuel supplies at lower prices, but this investment in infrastructure would help to stimulate much needed growth in the economy.

With a suitable regulatory framework, investment and job creation will flow into the economy for 5-10 years before the recovery of these private sector investment costs begin.

We hope you find GSOG's comments helpful and if you would like to discuss any of the points raised in more detail, please do not hesitate to get in contact.

Yours sincerely

APPENDIX A

GSOG SIGNATORIES

Centrica Storage Ltd
E.ON Gas Storage UK Ltd
Eni UK Ltd
Gateway Gas Storage Company Ltd
Halite Energy Group
Humbly Grove Energy Ltd
INEOS Enterprises Ltd
Infrastrata Plc
King Street Energy
ScottishPower Energy Management Ltd
SSE Hornsea Ltd
Statoil (UK) Ltd
WINGAS Storage UK Ltd