15 November 2017
OPEN LETTER sent by Moffatt Associates (95 Wilton Road, London SW1V 1BZ) on behalf of the signatories identified below.

The Rt. Hon. Greg Clark MP,
Secretary of State,
Department of Business, Energy and Industrial Strategy,
1 Victoria Street
London
SW1H 0ET

Dear Secretary of State,

Re: GAS SECURITY – REQUEST FOR AN URGENT INQUIRY

We the undersigned believe that the growing risks to gas security pose an urgent and serious threat to economic growth and employment.

Cost-effective security of energy supplies is at the heart of your industrial strategy, but we are concerned that the Government is ignoring the energy price implications of the UK's rising dependency on imported gas, forecast to reach up to 80% of total gas demand by 2030 (National Grid Future Energy Scenarios – July 2017). This rising level of exposure to the vagaries of the international gas market, combined with an inadequate level of UK gas storage, will increase both the likelihood and impact of short term demand-supply imbalances on both gas and electricity price volatility, to the detriment of all consumers.

Following the announcement of the imminent closure of the Centrica Rough Gas storage facility, the level of UK gas storage relative to demand has dropped dramatically at a time when the geo-political risks to imports have increased significantly.

The recent Government Strategic Assessment of Gas Security of Supply (BEIS - Oct 2017) concludes that *"our system is robust*". This analysis is misleading because it focuses only on potential import supply capacity, and ignores the potential dangers associated with just-in-time delivery and price security resulting from the UK's growing dependency on imported gas.

Whilst the UK may have sufficient import capacity, it does not guarantee that gas will be available (in either LNG terminals or via pipeline connections) to flow into the UK in the short term. As the IEA has pointed out recently, *"security of (LNG) supply cannot be taken for granted"* (Global Gas Security Review – How LNG Market Flexibility is Evolving" – October 2017). The IEA cites the case of delays in LNG supplies to Southern Europe last Winter, which resulted in prices escalating to the highest in the world.

In its own recent report, BEIS admits that at times of system stress *"LNG imports might be limited by the speed with which the market responds"* and *"where there is regional stress pipeline imports may also be limited"* and that *"gas storage has the capability to provide a source of flexible capacity in the intervening period"*. Without adequate UK gas storage, industrial and residential consumers face the prospect of greater and more frequent spikes in both gas and electricity prices.

We therefore call on the Government to mount a fresh inquiry into gas security, with particular reference to the adequacy of UK storage, gas price security and the possibility of taking some form of regulatory action to mitigate the impact of increased energy price volatility.

Our reasoning is as follows:

1. **Inadequacy of UK gas storage**
   The risks to security and energy costs have been highlighted by the closure of Rough, resulting in a substantial reduction in the level of insurance cover against any market stress from a shortfall in pipeline or LNG shipments and/or a sudden surge in demand – down to less than 5 days average Winter supply or less than 2% of total annual gas demand, compared with an average of 25% across the EU.

   The UK does have the benefit of diverse sources of imported gas supplies, and officials in BEIS and Ofgem take the view that some short-term price volatility may be desirable, because it attracts more pipeline and LNG gas to the UK. However, as we have noted above, the responsiveness of imports is a function of the world market and simply having a lot of import capacity does not guarantee that supplies will be forthcoming when required. Furthermore, it is gas consumers (and not shippers and suppliers) who are financially exposed to the ensuing higher prices.

   Suppliers and shippers are able to transfer their risk to their customers by buying gas in the forward markets and then adjusting the price they charge to customers. They therefore face no, or little forward price exposure to expected tight supply conditions. They are exposed to a certain degree to high cash out prices if there is a security of supply issue, but the incentives to balance do not adequately reflect the true cost of flexibility in the market. Therefore, consumers are likely to suffer a detrimental impact from both long-term supply fears and short-term supply shocks.

   During a late cold snap in March 2013 (see below) both LNG terminals and gas storage facilities were largely depleted with a limited ability to respond to UK demand. The resulting gas price spikes of March 2013 reflected a 4-6 week period of scarcity, which resulted in the UK economy and consumers incurring additional costs approaching £350m.

2. **Impact on electricity generation**
   Gas currently provides >40% of power generation and 70% of all heating. Furthermore, its role in supporting electricity system balancing is set to rise sharply as coal-fired generation closes and the amount of intermittent renewable generation increases. This means that gas demand will fluctuate dramatically, heavily dependent on the weather and time of day. National Grid Gas has forecast that by 2020/21, the variation in gas demand due to wind alone could be around 90 million

cubic meters per day (mcm/d) – (National Grid UK Future Energy Scenarios – July 2013 Section 4.3.6). This is exceptionally high compared with UK average daily demand of around 200 mcm/d. Without a minimum level of reliable and flexible gas storage capacity, there is little ability to meet this variable demand, which will impact negatively on the availability and cost of power at times of peak demand. The frequency and impact of these price spikes is set to increase, adding another layer of operational and investment uncertainty for gas generators at a time of low Capacity Market clearing prices and unpredictable market revenues. The recent National Grid Future Energy Scenarios (July 2017) highlights that based on current sources of gas supply, in particular the reduced levels of gas storage, security margins could fall to below zero, if a major source of imported gas (e.g. LNG from Qatar) were to be disrupted.

3. **Impact on industrial users**
   Major industrial users such as the ceramic sector are particularly at risk. Up to a third of ceramic production costs are energy related and gas provides 85% of that energy requirement. The ceramic sector employs ~ 20,000 people with an annual turnover in excess of £2bn. For example, during the March 2013 scarcity episode described above, some operations were suspended and, more widely, Unions were briefed at members' request on the potential for lay-offs. Contrary to what BEIS might believe, major energy users can only forward purchase a proportion of their gas consumption given the commitment to buy a specified volume. This is particularly the case where batch processes are used, because orders (and thus gas consumption) cannot be predicted months or years ahead. In addition, when day ahead prices rise, it is quite likely that forward prices will rise as well given the impact of market sentiment.

4. **Future investment in gas storage**
   The UK's comparatively low level of gas storage does not look set to increase, with a number of proposed and fully consented storage projects being cancelled (such as Baird and Caythorpe), put on hold, or struggling to attain a final investment decision (FID). Given the economic challenges for gas storage in the UK, no FIDs have been taken for over 10 years. To compound the problem, Centrica Storage (Rough) has just closed the major Rough Storage Facility and SSE (Hornsea) has announced reductions in the level of capacity at its facilities.

   Gas storage is a long-term, capital intensive investment and recent seasonal price differentials have brought into question the viability of existing capacity and have been insufficient to support the level of investment required to replace Rough. If a minimal level of UK gas storage is to be retained as a component of system resilience and insurance against international market price volatility, some form of regulatory framework will be required to support new and existing capacity, as is common on the Continent.

5. **Geo-political supply risks**
   In addition to the lack of gas storage, there are a number of geo-political risks impacting on gas supplies to the UK. Brexit for example poses a clear problem. In the

past, when demand has been exceptionally high, the UK has relied on imports of pipeline gas from other EEA countries. Again, in the very cold spell in March 2013, the Interconnector and the BBL pipelines were both operating at close to 100% of capacity. Together they were supplying almost 25% of UK gas demand in that month. We do not know what will happen as a result of the Brexit negotiations, but unless the Government can secure free access to European gas supplies, the UK may not be able to rely on this source of peak gas in the future. There are also concerns about the security of UK LNG supplies. Several key states in the Middle East have broken off diplomatic relations with Qatar, the supplier of most of our LNG cargoes in recent years. Whilst this may not be as much of a concern as the other issues, and it may well be temporary, it nonetheless underlines the growing uncertainty surrounding UK gas security.

There is a view gaining strength in industry that the closure of Rough has highlighted the urgent need for Government to review the risks impacting on gas supplies and energy price security.

In preparing this letter, we have consulted with National Grid, who have indicated to us that the continued importance of gas for generation and heating combined with the rise in import dependency have increased the potential risks to physical gas supply security, which in turn could increase the frequency and impact of gas and electricity price volatility. National Grid believe it is important to remain vigilant on gas security of supply.

We would welcome an early meeting with you and your officials to discuss the serious concerns expressed in this letter.

In connection with a possible meeting we should be grateful if you could respond initially to Clive Moffatt of Moffatt Associates (E-mail clivem@moffatt-associates.com Tel: 07831571776) who is acting as our coordinator on this initiative.

We look forward to hearing from you.

Yours sincerely,

Dr Laura Cohen – Chief Executive – British Ceramic Confederation
Andrew Large – Director General – Confederation of Paper Industries
Eddie Proffitt – Technical Director - Major Energy Users Council
Mike Foster – CEO – Energy & Utilities Alliance
Catherine Gras – CEO – Storengy UK
Adrian Pocock – CEO- InfraStrata and Islandmagee Storage
Jane Gratton – Head of Business Environment & Skills Policy – British Chambers of Commerce
George Grant – CEO – Stag Energy
Stuart Fegan – National Officer, Gas – GMB
Kevin Coyne – National Officer, Energy – Unite
Tony Devlin – National Officer, Chemicals, Pharmaceuticals, Process, Textiles & Downstream Oil Distribution - Unite