Cash Out Review Working Group Minutes
Meeting 05 – 'Gas emergencies' session 1
24 January 2005, 1 pm – 5 pm
Ofgem, 9 Millbank, London

Attendees

Matthew Buffey (chair)	Ofgem	Neil Smith	E.ON
Fiona Lewis	Ofgem	Rachel Turner	Centrica
Bill Reed	RWE	Adam Cooper	Merrill Lynch
Eddie Blackburn	Transco	James Lawson	Centrica Storage
Martin Mate	British Energy	Joy Chadwick	Exxon Mobil
Paul Mott	EdF Energy	Libby Glazebrook	First Hydro
Rekha Patel	Conocophillips	Stephen Jones	BG Group

All materials associated with this meeting will become available on the Ofgem website www.ofgem.gov.uk *under Ofgem's Work > Cash Out Review*

Emergency cash out arrangements

Transco presented its paper on the current emergency cash out arrangements and the potential perverse incentives associated with the current arrangements. Transco described how, following the replacement of top up with the safety monitor, there is a scenario whereby storage stocks can gradually be run down and that this effectively represents a count down towards a potential emergency. With this in mind, Transco asked whether the current emergency cash out prices were appropriate for such a foreseeable emergency situation? **Transco was asked by the group to clarify the relationship between Transco and the NEC and any changes that will arise from the DN sales. Transco to report back next week.**

The group discussed the following questions:

1. Are there any incentives on producers to withhold gas, or for shippers not to try to source gas?

   - The group considered that under the current arrangements shippers are incentivised to balance and if they were seen not to be actively trying to source gas in an emergency they could face a fine from Ofgem. The group also considered that companies would have to take into account the reputation of the firm. If the company was short of gas on a day and did not try to source gas and the system went into an emergency, it could affect the share price of that firm.

   - The group also considered that in stage one when the market still would be operating, the price would be high incentivising producers to bring gas onto the system. The neutral cash out price in stage two should encourage producers to bring all the available gas on in stage one helping to alleviate an emergency situation.

2. Could one shipper force the system into an emergency?

   - Transco explained that since the removal of top up, if the gas in store falls below the safety monitor level, Transco would declare an emergency. Transco considered that a shipper removing gas from store could trip the system into an emergency. The group did not consider that any one shipper could lead the system into an emergency but agreed with Transco that a number of shippers independently removing gas from store could cause the level of gas to fall below the safety monitor levels. The group considered that traders would have no option other than to remove gas from store to try to get back into balance.

   - Transco suggested that as a potential solution to the safety monitor problem, it could manage storage in stage one and stop shippers withdrawing the gas with the aim of keeping the market open for longer. This suggestion was not popular with the group.

3. Would the current cash out arrangements provoke the necessary demand response?

   - The group considered that the demand side response may not be adequate especially as shippers would not generally contract in advance for demand side response as a rule. However, the group considered that, it would take a significant period of time for storage levels to run down to close to safety monitor levels, which would leave sufficient opportunity for shippers to contract for demand side response.

   - The group also considered that the very large loads needed in stage one to provide demand side response, i.e. large power stations, would be unlikely to enter into these contracts or if they do, it would be at very high premiums. This would be especially true during winter peaks. It was suggested that other large industries should be targeted to provide demand response, for example steel, paper and chemicals, however in the past these industries have also been reluctant to enter into these contracts.

   - It was suggested that Transco could enter into commercial contracts with these large loads to provide the necessary demand response to ensure 1 in 50 security. Transco stated that it is not their role to contract for supply and demand interruption, only for capacity interruption, as this was consistent with its residual balancer role. Ofgem supported the view that Transco contracting for demand response to ensure 1 in 50 security would be unlikely to be the most efficient outcome.

- It was also noted that bids only remain on the OCM for a week, it may be a better solution to allow the bids to remain on the OCM until called or the parties decided to remove them.

4. Would the current cash out arrangements stimulate the interconnector (and other sources of gas which had access to alternative markets) to provide the correct response in an emergency?

    - The group was concerned that having a neutral cash out price would not encourage flows from the interconnectors and Norway. It was suggested that in stage two after the OCM had been suspended, normal cash out arrangements could remain in place for interconnector flows, however it was decided that as the OCM would no longer be in operation, this would have no effect.

    - The group also considered that as long as there was a robust claims process in place, it should allow recompense after the event.

Issues to look at

The group was asked to consider what changes to the emergency arrangements could provide better commercial incentives to avoid an emergency and also, once in an emergency, could provide greater access to gas supplies to assist the system in moving out of an emergency.

A number of possible issues were identified:

- Out of spec gas. The group wished to know what level of such gas is available. If this level is significant, it may be appropriate to amend the arrangements to encourage this gas on to the system in an emergency**. Transco to report back next week on the potential amount of stranded reserves which in an emergency could be brought onto the system.**

- Interconnector response. The group considered that provoking the correct response from the interconnector was important, especially in stage two of an emergency when the OCM has been suspended.

- Cash out prices. Although the group did not consider that an amendment to the emergency cash out price was a priority (since there were already sufficient incentives to balance) some members of the group considered that it may be possible to amend the emergency cash out price to better encourage shippers to contract for demand side response.

- Stages of an emergency. The group considered that it may be possible to add extra stages to the emergency arrangements which could give Transco comfort that it was properly managing the emergency whilst at the same time allowing the market to function for as long as possible.

- Changes to shipper imbalance following emergency interruption. Ofgem considered that it may not be appropriate for a shipper's imbalance position to be become less short or in balance, if its customers are isolated by Transco in an emergency.

- Claims process. It was suggested that clarifying the claims process could help attract additional gas onto the system in an emergency.

The next meeting will take place Friday 4 February, 10.30 am – 4.30 pm at Ofgem's offices