

Draft note of gas safety reserve meeting

Date: 03 April 06

Time: 10-2

Location: Ofgem

The meeting opened with Sonia Brown (SB) thanking everyone for attending and for the work so far completed. SB highlighted that contributions consisted predominantly on qualitative analysis and, going forward from this meeting, the group would benefit from more quantitative analysis. SB also welcomed any contributions of how the events of the Gas Balancing Alert (GBA) on 13 March 06 would be relevant to any of the options. Whilst a date has not been confirmed for the next meeting, this is likely to be within the next few weeks.

The group were asked to partake as much as possible in the group discussions.

Above the line options

Option 1. The status quo - Peter Bolitho (PB), (E.ON)

PB spoke to Part 1 of the E.ON UK Discussion paper titled Gas Safety Reserve Review – The Merits of the Status Quo. The case for allowing the market to work.

PB indicated that separating between the above the line and below the line options was not straight forward as certain aspects are interrelated. PB noted that the current arrangements have not been in effect for very long, and indeed have not had the rigour of being tested in the full run-up to a winter. Thus there is not yet any evidence that the current arrangements are not working. SB noted that that may be the case, but we should always be looking for ways in which we could 'better facilitate'. There was also evidence that there was a clear lag between the GBA trigger (indicating system stress via high prices) and the resulting demand side response (DSR). PB stated that there was little or no observed lag in response times for CCGTs, but acknowledged that this lag may exist for total demand (across all classes of customer). The group needs to identify if this can be improved.

PB continued that the current arrangements give a clear distinction between NG and the market. DSR has been seen in the 05/06 winter, particularly from the CCGT's. This winter there is more time to contract. If there is certainty in the rules, then Shippers can be confident that the contracts they may currently be developing will be able to be utilised this winter. This stability would give the market a chance to work.

A group member noted that some DSR was due to price avoidance from customers exposed to the spot price. These customers may take a more risk averse position this winter because of the consequences of high price levels. If customers lock in contracts then they are no longer exposed to the spot market. Thus they may be less likely to respond given they are purely interested in their own production. This could result in a less elastic demand response from these areas of industry.

The group discussion moved on to incentives for replacement fuel for gas such as oil or distillate. At what gas price would these alternatives become viable? PB stated that 90p/therm had been previously quoted as being high enough for customers to switch (if they have the option to do so). However, if investment would be required in infrastructure then this is likely to be a lot higher and certain members of the group felt that it may even be prohibitive. A lot of this infrastructure has previously been removed and a full return on investment is required in order for it to occur. A further quantitative study would be useful in this area.

SB noted that Shippers need to provide evidence to satisfy the industry that demand response will be better (and more timely) in the coming winter. For example, evidence that products offered for winter 05/06 were being further developed and / or being promoted to customers. PB stated that E.ON were currently doing this. However, the group did not confirm whether all shippers were doing this.

PB concluded by giving a rundown of the points summarised in page 6 of the paper.

Option 2. Amber Alert – Fiona Lewis (EDF Energy)

Fiona introduced the main costs and benefits from the paper 'Homework from Gas Safety Reserve Meeting on 1st March 2006'. She concluded that the costs would on balance, outweigh the benefits.

The group discussed National Grid's (NG) use of multi-day trades in the context that it may not use all its available tools. It was expressed that the level of demand is difficult to forecast especially when seeking to accommodate the level of DSR which is based on participant behaviour. This inherently makes any multi-day trades dependent on individual views rather than statistical analysis.

SB stated that this option should predominately focus on the use of the "amber alert" as an increased information tool. NG's use of multi-day trades was not necessarily part of this option, and could be assessed separately.

Group members noted that an information 'alert' would be likely to have an impact on price, increasing volatility. The question was posed that what new information would this alert present? If the market was functioning efficiently, then the signal to maintain storage should be reflected in the price. There was the view that customers would provide more weight to the 'authoritative' NG alert than to Shippers individual expressions of things becoming difficult. There was also a view that the NG website may not present information on forecast flows as clearly as may be possible – and is an issue that should also be addressed prior to winter 06/07.

It was discussed that NG currently provide Ofgem with a 5 day demand forecast, predominantly driven by Met office weather predictions. This forecast is not available to the market. However, provided the limitations and assumptions were communicated and understood, this could add value. There was some concern that this could condition the market but the overriding view was that the more information available, the better.

An action was put on National Grid to provide the 5 day demand forecast leading up to the GBA on 13 March 2006.

Option 3. Enhanced SO role – Phil Broom (Gaz de France)

Phil spoke to the paper Ofgem Gas Reserve Group – Discussion Paper. Workgroup 3 – Potential changes to National Grid toolkit.

An overriding key question is what will make the demand side respond more? The amount of response from CCGT's is capped by the need in the electricity market to maintain a margin of reserves. If the correct incentives are in place then there should be more demand response coming to the market.

The key question the group asked is why can't shippers already offer the contracts that NG would provide under this option? Theoretically, a monopoly will be less efficient than competitive companies and this would result in inefficiencies that filter's into cashout prices.

The argument put forward is that this option would provide a route to market for DSR which currently is not made available. Questions were raised as to whether there is currently a barrier to customers making these contracts with Shippers, and would NG provide any economies of scale if they had this role.

In terms of quantifying the costs of this option, it was noted that calculating the distortionary effects would be a difficult exercise. There was also concern with this option that Shippers might have disincentive to pursue demand reduction as NG would have this role.

Action on Peter Bolitho to estimate the size of the premium that NG pays when it contracts through a tender process for flexibility products, compared to when these are offered by shippers through open market mechanisms.

Option 4. Changing the National Grid objective function, preserve storage stocks – Shelly Rouse, Statoil

Shelly Rouse introduced the Pros and cons of this approach. The group felt that this would be an unnecessary 'big brother' role for NG. The question of what does NG know that Shippers don't was again expressed.

The group was asked whether this option should continue to be assessed as there did not seem to be much support for it. One member felt that there were customers who would be interested in this option.

An action on Helen Bray from CIA to provide a customer based response with supporting analysis that includes what the current market failure is and why changing the objective function is a better option than the status quo.

Below the line options

Option 1. Status Quo – Peter Bolitho (E.ON).

PB briefly introduced Part 2 of the E.ON UK Discussion paper titled Gas Safety Reserve Review – The Merits of the Status Quo. The case for allowing the market to work.

PB briefly discussed the summary on the last page of the paper. The group discussion centred on the negative points in relation to option 2 below, including the potential for rogue players to undermine contracts and the potential for option 2 to be prohibitively expensive.

Option 2. NG Contract - Stuart Waudby (CSL)

Stuart gave a presentation on the details of this option.

The discussion following this concentrated on the economic validity to contract ex-ante rather than to compensate ex-post. The group felt that it would be unlikely that premiums asked for option contracts would be reasonable. Concern relating to whether the gas can be guaranteed by option contracts led to the opinion that NG would have to take title of this gas.

PB considered that a more appropriate approach would for the status quo arrangements to be retained for "below the line", although it may be appropriate to amend the compensation arrangements (possibly through more effective targeting of payments).

An action on PB to develop proposals in more detail on how the compensation arrangements under the (below the line) status quo could be improved.

Way Forward

The group has analysed the quantitative issues and feels it is important to consider quantitative analysis such that the options can be narrowed down to as few as possible. Any required modifications can be brought forward in time for this winter.

An action on Ofgem to provide the group with a set of questions (pro forma) that will attempt to provide some quantitative support for the options. Specifically, the level of expected demand side response for the coming winter is of interest. Ofgem will then aggregate this data for presentation to the group.