



*Promoting choice and  
value for all customers*

Attention all:  
Gas Transporters, Gas Shippers, Customers, Market  
Participants and Interested Parties

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### **Emergency Arrangements**

Over the past few months a number of exercises and meetings have been conducted by the industry to test the resilience of the gas and electricity systems in response to sudden and extreme events, such as major storm damage. These discussions have identified some areas as needing review, including in relation to the gas market. Ofgem shares these concerns, and we are writing to you as we are looking to work with the industry to take forward a review of these issues as a matter of urgency ahead of the peak winter months.

A review of three aspects in particular of the gas market arrangements should be considered:

#### *Gas emergency cash out arrangements*

Ahead of last winter significant changes were made to the emergency cash out arrangements for gas. These were designed to improve the incentives on gas shippers to take measures to avoid an emergency. The most significant change was to alter the way in which the cash out price was calculated in an emergency so that, instead of being set at the mean System Average Price of the last 30 days, it would be set on the basis of the prices prevailing at the time that stage 2 of an emergency is declared. In addition to this an Emergency Curtailment Quantity title trade was introduced. This resolved an issue whereby certain parties may have benefited from waiting for National Grid to declare an emergency rather than taking actions themselves to resolve any potential shortfalls of gas, hence limiting the incentive to balance to avoid an emergency.

At the time that the decision was taken we outlined areas where further thought was going to be required. This included the interaction of the GB wholesale gas market with markets that it is linked to. Following the industry working through a number of scenarios for emergency situations, it is clear that, although the new arrangements continue to represent an improvement over the previous arrangements, there are areas where further development is required.

In particular, it is possible for an emergency to last for an extended duration. In these circumstances, the emergency cash out price that was set at the start of the emergency is unlikely to be appropriate throughout the duration of the emergency. At times this price may well be too high - at other times it could be too low. A cash out price that is potentially either too high or too low will have perverse effects on market participants' incentives and therefore the economic and efficient operation of the gas system. As GB becomes increasingly reliant on gas imports, a cash out price which appropriately reflects conditions on the system is also important to attract gas from abroad when it is needed.

Therefore, one area of investigation will be to assess whether it is possible to establish a cash out price that has the potential to reflect better the demand and supply balance in emergency conditions than the current rules.

#### *Credit Arrangements*

Under emergency arrangements, extraordinary prices could severely impact the immediate financial positions of shippers, potentially leading them to default. Combined with a tense emergency industry atmosphere, this presents a risk of systemic shipper default, and has the potential to worsen an already bad situation.

We would like, therefore, to be reassured that robust industry credit arrangements are in place that would isolate default, and prevent - even under emergency circumstances - systemic company failures.

#### *Emergency contact information*

Tests carried out by industry to simulate emergency situations have frequently highlighted an issue with the ability to contact customers in such situations. The participation of large customers is vital to the management of a gas emergency, and it is apparent that the current contact details may be inadequate. Contact mechanisms must be robust to account for the fact that a single individual cannot always be available, and that technology is not always reliable. A review of contact details is needed so that each organisation has a number of contacts available in an emergency situation.

We would also like industry to consider the best way to ensure that customers curtail their demand when required in an emergency situation. The current arrangements impose an obligation on customers to curtail demand when requested in a stage 1 potential or stage 3 actual emergency. We need to be sure that customers are well placed and sufficiently incentivised to respond to such requests as quickly as possible given the highly critical nature of their actions.

If you have any questions or would like to discuss these issues please contact me on the above number. Alternatively Jo Witters (020 7901 7159) would be very pleased to help.

Yours sincerely,

**Sonia Brown**  
**Director, Wholesale Markets**