

# **Gas Security of Supply – Significant Code Review**

## **Opening stakeholder seminar**

**Chair: Giles Stevens**  
**Head of Competition Economics, Ofgem**

18 January 2011

## Agenda

- 14.00 – 14.20: Tea/coffee
- 14.20 – 14.25: Introduction - Chair
- 14.25 – 14.45: Presentation – Ian Marlee (Ofgem)
- 14.45 – 15.05: Presentation – Mark Ripley/ Andy Malins (National Grid)
- 15.05 – 15.25: Presentation – Chris Wright (Centrica)
- 15.25 – 15.45: Presentation – Jeremy Nicholson (Energy Intensive Users Group)
- 15.45 – 16.45: Q&A
- 16:45: Closing Remarks - Chair
- 17.00: Close

# **Gas Security of Supply – Significant Code Review**

## **Opening stakeholder seminar**

**Ian Marlee  
Partner GB Markets**

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## Purpose of today's seminar

- 1. Provide an overview of the Gas SCR**
- 2. Outline potential options for reform**
- 3. Next steps**

# 1. Overview of the Gas SCR

- Why are we doing it?
- Why now?
- Our key objectives for the review

## Why are we doing it...

- GB gas market has delivered
  - **However**, concerns remain whether the current arrangements will deliver security of supply, and growing import dependency exacerbates these concerns
- **Project Discovery**
  - Assessment of whether market arrangements in GB can deliver secure, sustainable energy supplies
  - Concerns include:
    - Security of supply is not fully priced
    - Frozen cash-out may not attract gas during an emergency
- **Government priority**

## Why now? [I]

- Incremental improvements have been made
- **But** the unavoidable piecemeal nature of the modification process has proven a major obstacle to reform
- Ofgem has expressed concerns for some time, including our decisions on UNC mod proposals 021, 149 and 260
- UNC mod proposal 149 (October 2007) rejected as there was no price cap, however we maintained:  
*'some form of dynamic cash-out pricing, or other alternative arrangement, is required to attract gas into the GB market under emergency conditions.'*

## Mod 260 still leaves concerns

- UNC 260 (Nov 2009) introduced arrangements that attempt to 'mirror' dynamic cash-out
  - Shippers can claim (ex-post) up to their opportunity costs for delivering gas to GB in the event of an emergency
- However there are remaining uncertainties
  - e.g. risk of delays associated with the assessment of these claims
- We stated that:
  - '...a wide ranging review of the (emergency) arrangements is necessary as part of a broader review of security of supply in the GB market.'*



## Why now? [II]

- New Significant Code Review (SCR) process
  - allows holistic approach to reviewing code-based issue
  - The SCR process 'went live' on 1 January 2011
- Government priority
  - Proposed a new statutory power to allow reforms to be in place by winter 2011-12
  - Energy Minister, Charles Hendry:  
*"The security of supply of gas is a top Government priority in the UK...The energy security and green economy bill contains measures to strengthen the market incentive mechanism for ensuring sufficient gas is available."* (Parliament, December 2010)

## Our key objectives for the review

- Our key objective is to enhance gas security of supply in an efficient manner. We are seeking to:
  - a) minimise the likelihood of a gas emergency occurring
  - b) minimise the duration and severity of a gas emergency if one was ever declared
  - c) appropriately compensate firm consumers if they ever were to be interrupted
- Enhanced obligations remain on the table
- We will be conducting an impact assessment to help ensure the best outcome for consumers

## 2. Outline Potential options for reform

- Options for reforming the emergency cash-out arrangements
- What about VoLL?
- Compensation for firm customers interrupted
- Are obligations needed?

# Options for reform – emergency arrangements

Element	Current arrangements	Option 1	Option 2	Option 3
<b>Shipper-to-shipper trading</b>	Continues	Continues	Suspended	Suspended
<b>Cash-out price</b>	Frozen	Dynamic	Dynamic	Frozen
<b>Post emergency claims</b>	Required	Not required	May be required for domestic supply	Required
<b>Role of VoLL</b>	None	Administrative price cap(s) at VoLL	Administrative price cap(s) at VoLL	Administrative price cap(s) at VoLL
<b>NGG role</b>	No market balancing actions	Market balancing actions set cash-out	Market balancing actions set cash-out; Sole purchaser of gas from non-domestic sources	Sole purchaser of gas from non-domestic sources
<b>NEC role</b>	Authorise firm load disconnection; Authorise instruction of maximum flows from domestic sources	Authorise firm load disconnection	Authorise firm load disconnection; Authorise instruction of maximum flows from domestic sources	Authorise firm load disconnection; Authorise instruction of maximum flows from domestic sources
<b>Compensation for firm customers disconnected</b>	None	Compensation at administrative VoLL(s)	Compensation at administrative VoLL(s)	Compensation at administrative VoLL(s)

## What about VoLL?

- VoLL (the value of lost load) is the value that customers attribute to secure gas supplies
- **VoLL is a common element to our reform options**
  - VoLL would set the maximum cash-out price and compensation
- **But VoLL is difficult to estimate**
- **Next steps include:**
  - Establish VoLL estimates
  - Engage with I&C customers (i.e. Demand-Side Working Group)
  - Consumer engagement (i.e. hold a consumer panel to discuss qualitative issues)

## Compensation for firm customers interrupted

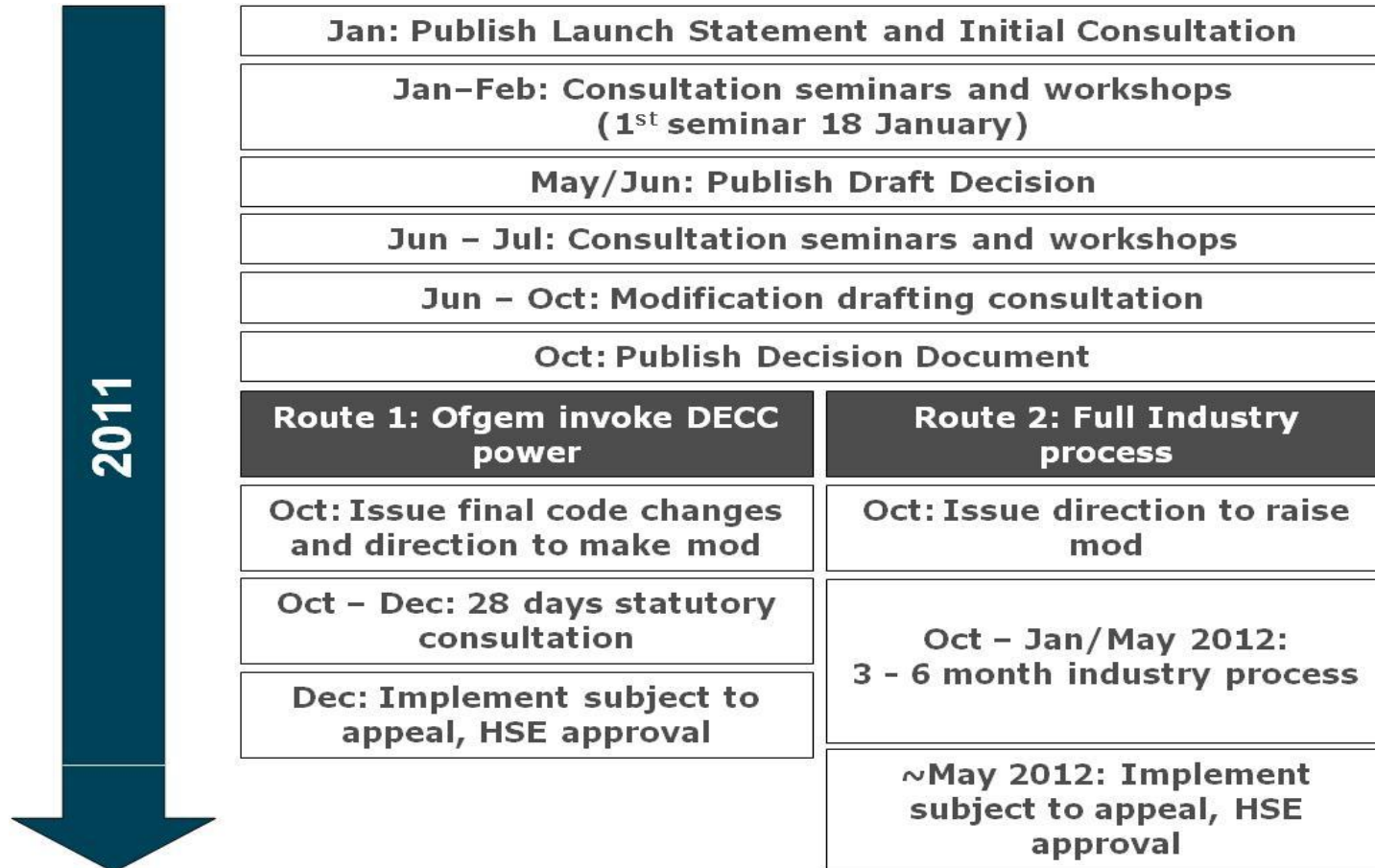
- Currently, firm interruption is in effect a 'free option'
- The costs of interruption to firm consumers could be significant
  - Should consumers be compensated at VoLL?
  - Should these costs be targeted at short shippers for the full duration of the interruption, or socialised?
- Incentives to enter interruptible contracts?
  - We are keen to hear views from large customers in particular

## Are obligations needed?

- Reform of the emergency arrangements will improve incentives to manage risk and investment incentives
  - **BUT**...it's difficult to get these incentives right; will industry respond adequately?
  - **AND**...need to consider potential unintended consequences
- Consequently, supplier and/or SO obligations still on table
  - **BUT** there are complex design issues, they should not be considered an easy option
  - **AND**...need to consider potential unintended consequences
- Various combinations are possible

## **3. Next steps**





Note: Following consultation, if we decide that obligations are needed then the relevant licence conditions should be in place for December 2011, but we would not expect obligations to become enforceable until winter 2012-13.

## Initial Consultation – stakeholder engagement

Event	Scope	Date	Time/ location
Opening stakeholder seminar	<ul style="list-style-type: none"> <li>• Open invite</li> <li>• Present issues and options</li> <li>• Q &amp; A session</li> </ul>	<b>Today</b>	14.00-17.00 Broadway House
Workshop 1	<ul style="list-style-type: none"> <li>• Attendees by invite</li> <li>• Topic – <i>Potential options for reform of the emergency arrangements</i></li> </ul>	21 January 2011	9.30-12.30 9 Millbank
Workshop 2	<ul style="list-style-type: none"> <li>• Attendees by invite</li> <li>• Topic – <i>VoLL and compensation arrangements</i></li> </ul>	28 January 2011	10.00-13.00 9 Millbank
Workshop 3	<ul style="list-style-type: none"> <li>• Attendees by invite</li> <li>• Topic – <i>The case for obligations and the criteria for an impact assessment</i></li> </ul>	4 February 2011	10.00-13.00 9 Millbank
Closing stakeholder seminar	<ul style="list-style-type: none"> <li>• Open invite</li> <li>• Present conclusions</li> <li>• Open discussion</li> </ul>	<b>9 February 2011</b>	14.00-17.00 Broadway House
Deadline for responses		<b>22 February 2011</b>	

The background of the slide is a composite image. On the left, there are rows of solar panels under a bright sun. On the right, a hand is shown holding a white document. In the bottom left corner, a blue gas burner is visible. The overall theme is energy and customer service.

*ofgem*

Promoting choice and value  
for all gas and electricity customers