

Gas Significant Code Review – closing seminar for initial consultation

Date: Wednesday, 9 February 2011

Time: 14:00 – 17:00

Location: Broadway House, Tothill St, London, SW1H 9NQ

1. Attendees

1.1. A list of attendees is contained in attachment 1.

2. Introduction – Giles Stevens (Ofgem)

2.1. Giles Stevens welcomed attendees and thanked them for attending. He noted that this seminar was part of a wider initial consultation process on the Gas security of supply Significant Code Review (Gas SCR), including workshops. He then outlined the agenda for the seminar (see the second slide in Ofgem's presentation – link below).

3. Presentation – Andrew Wright, Ofgem

3.1. The slides for this presentation are available on Ofgem's website:
<http://www.ofgem.gov.uk/Markets/WhIMkts/CompanEff/GasSCR/SemWrkShp/Documents1/Gas%20Significant%20Code%20Review%20Closing%20seminar%20-%20Ofgem%20Presentation.pdf>

3.2. Andrew provided an overview of the key messages from the Gas SCR consultation to date, Ofgem's early reactions and the next steps. Andrew noted there is a gap at the heart of the gas market arrangements whereby security of supply is not adequately valued. He added that problems with gas emergency cash-out arrangements and the lack of compensation for firm customers disconnected are real (rather than theoretical) concerns. Andrew highlighted the importance of consistency between gas (commodity) market and network arrangements. He said he would prefer an approach to be robust to different types of an emergency (slow burn vs rapid), but noted different arrangements may be worth considering. Andrew also said that the Value of Lost Load (VoLL) doesn't need to be right for all customers, as it will incentivise people to discover their own VoLL.

3.3. Andrew noted this is the first stage of consultation and that all options remain on the table. He also emphasised the importance of providing written responses, with evidence where possible, to the initial consultation paper by 22 February 2011.

4. Presentation – Mark Ripley, NGG

4.1. The slides for this presentation are available on Ofgem's website:
<http://www.ofgem.gov.uk/Markets/WhIMkts/CompanEff/GasSCR/SemWrkShp/Documents1/Gas%20Significant%20Code%20Review%20Closing%20seminar%20-%20National%20Grid%20Gas%20Presentation.pdf>

4.2. Mark highlighted the importance of focusing on prevention and improving oversight and transparency. He also explained the importance of identifying clear roles and responsibilities and the need for any new arrangements to retain or improve safety. Mark also provided his final thoughts on the initial phase of the process. He noted that dynamic cash-out and compensation are worth considering, but was unconvinced of a need to change the role of the National Emergency Coordinator (NEC) and was unclear

how NGG could be as efficient as shippers if NGG was to act as a central buyer in an emergency.

- 4.3. Mark noted that incremental changes to the arrangements for 2011/12 would be good but not essential, and that it would be better to get it right rather than having to go back to review it every few years.

5. Presentation – Richard Street, Corona Energy

- 5.1. The slides for this presentation are available on Ofgem's website:
<http://www.ofgem.gov.uk/Markets/WhlMkts/CompanEff/GasSCR/SemWrkShp/Documents1/Gas%20Significant%20Code%20Review%20Closing%20Seminar%20-%20Corona%20Presentation.pdf>
- 5.2. Richard summarised a number of positive and negative points in relation to the consultation process to date. He said that evidence was required to prove there is a problem with the current arrangements. Richard noted that if market incentives were applied these would drive the least cost option through insurance, flexibility products or accepting the risk. He also noted that obligations would likely distort the market and that, with obligations, small suppliers would be unable to compete with the vertically integrated suppliers. Richard noted that extra costs will fall on consumers.

6. Presentation – Eddie Proffitt, Major Energy Users Council

- 6.1. The slides for this presentation are available on Ofgem's website:
<http://www.ofgem.gov.uk/Markets/WhlMkts/CompanEff/GasSCR/SemWrkShp/Documents1/Gas%20Significant%20Code%20Review%20Closing%20Seminar%20-%20Major%20Energy%20Users%20Council%20Presentation.pdf>
- 6.2. Eddie provided his views on the three workshops. Eddie noted that he has never seen the logic of freezing the market in an emergency. He also noted that he cannot see the advantage of capping the cash-out price at VoLL, as shippers/suppliers with no obligations would withhold supplies until the price rose to VoLL. Eddie was concerned there had been no discussion of the actual level of VoLL at the workshop, despite Ofgem providing estimates for discussion. He noted the need for urgency and new SCR powers and was of the view that existing interruptible contracts could provide protection for winter 2011/12 and suggested delaying implementation of modification 367 to October 2012.

7. Q&A Session 1

- 7.1. In this session, attendees were invited to ask questions of Andrew Wright (Senior Partner, Ofgem) — questions are in bold.
- 7.2. Andrew responded to the earlier presentations. He noted that security of supply is not properly valued in the current arrangements and that the risk of a gas emergency is with customers and probably government. Andrew noted that the arrangements need to allocate risk to where it can be best managed. He also noted that the gas market is a very responsive market and that he is not convinced that industry does not respond to incentives.
- 7.3. **Prices will rise significantly in an emergency. The interconnector is the last resort of flexibility. However, differences in gas quality between the UK and Europe is an issue that needs addressing. Why are we not talking about these issues?**
- 7.4. Andrew agreed the interconnector was critical. He also noted that gas prices could go very high and could tip incentives for investment in solving gas quality issues.

7.5. Why are Public Service Obligations (PSOs) not given sufficient attention? This is not a new issue (Poyry and Oxera reports have discussed these in the past). PSOs are more cost effective and can avoid investment in strategic storage. The new EU Energy Directive is not against PSOs and in Europe they are viewed as market based.

7.6. Andrew noted that obligations remain on the table.

7.7. In relation to high probability and low impact events, the VoLL represents consequential loss. Does the electricity market also have consequential losses?

7.8. Andrew noted that an electricity cash-out SCR will look at this type of issue.

8. Q&A Session 2

8.1. In this session, attendees were invited to ask questions of the panel which consisted of Giles Stevens, Ian Marlee, Mark Ripley, Richard Street, Eddie Proffitt and Peter Sherry (Senior Economist, GB Markets) — questions are in bold.

8.2. Is there a gas security of supply problem to be solved and if so, how is this problem defined?

8.3. Eddie noted that if the cold weather conditions in December had continued for the rest of winter, we would have had real issues.

8.4. Mark noted the review was timely as GB becomes increasingly reliant on non-domestic gas supplies. He said that diversity of gas supplies was good for security of supply, but under tight conditions it means that we will be competing for gas with other countries that might manage security of supply differently.

8.5. Ian noted that the current market arrangements do not adequately value security of supply. He said that nothing he has heard to date has convinced him that we have an adequate level of security of supply currently. Ian noted that for a market to function well, it is important to get the price signals right. He noted that frozen cash-out and no compensation for firm disconnection meant that there may be inadequate signals to incentivise suppliers to invest in additional flexibility to improve security of supply. He also noted that Ofgem has held these views for a while.

8.6. Richard explained there are different views among suppliers, with one third believing there is a problem, one third believing there is not a problem and the remainder thinking there may be a problem and wanting to see the evidence. Richard said we need to understand the risks and noted that we now have very diversified supplies and are less reliant on domestic sources.

8.7. Is it a problem now?

8.8. Ian noted that the market should work out the appropriate level of risk provided the right price signals are there. However, he recognised that if shippers/suppliers do not respond to price signals then we are in the area of obligations.

8.9. Will Cutler (DECC) noted that the market has responded very well since 2005. He acknowledged that this has been at a time of global oversupply and on the back of a recession. He also noted that with declining domestic sources and increasing import dependency, shocks from external sources or infrastructure failures could result in an emergency occurring. Will highlighted Poyry's analysis on the risks of high impact low probability events. He noted the proposal in the new Energy Bill to allow for the outcomes of the Gas SCR to be implemented faster than would otherwise be the case.

The reason for this, he said, was that the risks to security of supply identified by Poyry are present currently, therefore there is no reason to wait to implement the reforms. Will noted that royal assent for the Energy Bill was expected in spring 2011.

8.10. The EU security of supply Directive requires DECC to provide a report on how to meet security of supply commitments. How will this effect security of supply?

8.11. Ian said this was an issue for DECC as the competent authority, but noted that market/price mechanisms are a way of meeting security of supply concerns.

8.12. Security of supply standards should be resilient for most foreseeable events. What is the security of supply standard for the gas SCR?

8.13. Ian suggested that security of supply standards (such as a 1 in 20 or 1 in 50 winter) could potentially be used to limit the compensation liability of shippers. In this way, if these security of supply standards are being met then no additional costs should arise, but if these standards are not being met then the additional cost is probably justified. Mark clarified the meaning of the 1 in 20 years and 1 in 50 years security standards, but noted that it is not an exact science.

8.14. Richard noted that in the case of a gas deficit emergency we are generally only talking about interrupting industrial and commercial customers. He said that if compensation or obligations were included in the arrangements then the price would rise which would be passed onto consumer bills. Richard noted that it will be important to consider the impact of any proposed option on liquidity and competition with a view to choosing the least interventionist option.

8.15. Peter noted that Ofgem was working with DECC on security of supply issues and highlighted that DECC was the component Authority in relation to the EU Regulation. Peter said that security standards can often be demonstrated more easily in continental Europe through PSO's and obligations, whereas in GB we rely on a market based solution. Hence, there has to be a certain faith in the market.

8.16. One of the attendees clarified that the 1 in 50 security standard was only ever in relation to domestic customers and that it was removed from suppliers' licences a few years ago. They also noted that in relation to the 1 in 20 standard, cash-out arrangements are supposed to incentivise this outcome through the Uniform Network Code (UNC).

8.17. Richard noted that the UNC requires shippers to balance in all circumstances. A participant responded and noted that this was a financial obligation rather than a physical obligation. Richard explained that there is an obligation not to put the physical system in jeopardy.

8.18. Final two questions: What is the measure of success for the Gas SCR? What changes would the panel make if they had to decide on the Gas SCR today?

8.19. Ian noted that Ofgem did not start this consultation process with a particular solution in mind and stressed the importance of open consultation. He noted that the objectives of the Gas SCR are to minimise the likelihood of getting into an emergency and, if an emergency were to occur, to minimise its duration and severity. Ian also noted that we need to look at the extent to which there are gaps in the current market incentives.

8.20. Mark said that we need to answer the question of whether any proposed solution is better than current arrangements. However, he noted that this was difficult in practice and it may be that we can only undertake a theoretical rather than practical measure

of success. That said, Mark noted that better information transparency would be one measure of success.

- 8.21. An attendee noted that security of supply has increased through diversification of supply sources and new infrastructure investment. However, he noted that NGG now has less information about how the market is acting and reacting in periods of system tightness. To this end, he expressed concern that there is little information on how market participants manage the low probability, high impact risk of a gas deficit emergency occurring.
- 8.22. Eddie noted that the measure of success would be that no firm customer was ever disconnected. Eddie also suggested we should introduce an obligation on the system operator to contract for interruption from customers.
- 8.23. Richard noted that the outcome should not be that money just moves around but that there are actual improvements in security of supply. He said that investment will take time though so it could take at least 5 years for improvements to be seen. Richard noted that unexpected things happen and that we need the tools to manage an emergency, to allow the market to get to the brink and be able to pull it back in a controlled manner. Richard noted from Corona's perspective they understand why consumers want compensation and believe having raised the prospect of compensation the industry will now need to address the issue. He added that compensation arrangements would need to be at least cost to the industry and that a real demand side tool was required. He also suggested that any solution should be adaptable so that changes in the market, such as smart meters, can be brought in under these arrangements.
- 8.24. Eddie quickly noted that perhaps security of supply is undervalued in GB by comparing the expectations of a French glass company with those of a GB glass company. In the former, the French company establishing itself in GB did not invest in any back-up despite the fact that any outage would have significant impacts for the plant. However, all GB glass companies have back-up. Hence, it could be that French gas supplies are more secure in GB.

9. Closing Remarks

- 9.1. Ian Marlee noted that under the current arrangements, the risks are with consumers and emphasised that risks should be allocated to where they can be best managed.
- 9.2. Peter encouraged written responses (indicating preferred solutions where possible) to the initial consultation by 22 February 2011.
- 9.3. Giles closed the seminar by thanking speakers and attendees for their attendance and active involvement.

Attachment 1 — list of attendees

Name	Company
Abid Sheikh	Ofgem
Alex Kemp	University of Aberdeen Business School
Alison Meldrum	Tata Steel
Andrew Pester	Ofgem
Andrew Wright	Ofgem
Andy Malins	National Grid
Anna Barker	Ofgem
Anna Saksonov	Ofgem
Antonio Ciavolella	BP Gas Marketing Ltd
Antony Miller	Ofgem
Arnaud Goffin	Storengy UK
Chris Wright	Centrica
Clare Cattle-Jones	Energy Networks Association
Colin Lyle	European Federation of Energy Traders
David Odling	Oil & Gas UK
Debbie Pritchard Jones	GrowHow UK Limited
Dora Ianora	Ofgem
Eddie Proffitt	Major Energy Users Council
Edward Cox	ICIS Heren
Fatima Sadouki	Gas Strategies
Fiona Strachan	Gazprom
Gareth Davies	Chemical Industries Association
Gerry Hoggan	Scottish Power
Giles Stevens	Ofgem
Graeme Thorne	Halite Energy
Ian Marlee	Ofgem
Jamie Black	Ofgem
Jenny Phillips	National Grid
Jeremy Nicholson	EIUG
Jill Brown	RWE npower
John Vercoe	Independent consultant
Julie Cox	Association of Electricity Producers
Karen McDonough	HSE
Laone Roscorla	Cornwall Energy
Lee Millard	Interconnector (UK) Ltd
Malcolm Arthur	National Grid
Mark Dalton	BG Group
Mark Freeman	National Grid Gas Distribution
Mark Rigby	Gateway Gas Storage
Mark Ripley	National Grid
Martin C Rawlings	Chartered Institute of Purchasing & Supply (CIPS) National Energy Group
Mike Potter	HSE
Mitun Patel	Gas Strategies
Peter Sherry	Ofgem
Philip Hindmoor	Innovia Films Ltd
Rekha Theaker	Waters Wye Associates
Richard Fairholme	E.ON
Richard Sarsfield-Hall	Pöyry Energy Consulting
Richard Street	Corona Energy
Ritchard Hewitt	National Grid

Name	Company
Roddy Monroe	Centrica Storage
Shelley Rouse	Statoil (UK) Ltd
Simon Trivella	Wales & West Utilities Ltd
Stefan Leedham	EDF Energy
Stephen Allen	Parliamentary Office of Science and Technology
Steve Reeson	Food and Drink Federation
Vanessa Webster	SBGI Gas Storage Operators Group
William Cutler	DECC