Minutes

Gas Significant Code Review — opening seminar for draft policy decision

Date: Tuesday, 30 November 2011
Time: 09:30 – 12:30
Location: Mary Ward House, London

1. Attendees

A list of attendees is contained in attachment 1.

2. Purpose of seminar

The seminar was chaired by Giles Stevens (Ofgem). He announced that the purpose of the half day seminar was to:

- outline the draft policy decision on the Gas SCR and the basis for the decision
- discuss stakeholder involvement going forward
- discuss initial stakeholder feedback.

3. Presentations

Several presentations were held in the first half of the seminar. The slides are available on the Ofgem website. The following stakeholders presented:

- Ian Marlee (Ofgem) on the Draft Policy Decision
- Vladimir Parail (Redpoint Energy) on the Modelling used for quantitative analysis
- Andrew Malins (National Grid Gas) on the System Operator's perspective
- Eddie Proffitt (Major Energy Users ' Council) on the perspective of gas users
- Nick Wye (for Gas Forum) on the perspective of gas shippers and suppliers.

Subsequently a Question and Answer session was held to elicit and discuss stakeholders views.

4. Questions and answers

This session sought to respond to stakeholders' questions and elicit stakeholder's initial views on the draft policy decision. It was held in the form of a panel discussion with the five presenters as panellists and chaired by Giles Stevens.

Question 1: What factors will Ofgem take into account when deciding on whether to progress any reforms through the usual industry process or the new powers in the Gas Act 1986?

Response:

- Ian Marlee outlined that Ofgem has not published any criteria for making this decision and that the answer will largely depend on the responses to the draft policy decision and whether Ofgem's final decision is substantially different from the draft decision.

Ofgem will also take timing issues into account (such as the start of the gas storage year, for example).

Question 2: The probability of an emergency occurring is very low according to the modelling. What security of supply standards is Ofgem trying to achieve in light of international developments, such as the standards set out in the European Union (EU) security of gas supply regulation?

Response:

- Ian Marlee outlined that Ofgem is seeking a market-oriented solution. Ofgem has used the EU security of supply standard when deciding on the appropriate Value of Lost Load (VoLL) to set cash-out prices based on the work of London Economics (ie a one week outage occurring once in 20 years in winter). In analysing the appropriate policy option Ofgem has also conducted a quantitative and qualitative analysis to assess consumer benefit as part of its draft impact assessment.

- Andrew Malins replied that this prompts a broader question as to the right level of security of supply. He suggested that this should be part of the further interventions work stream. He pointed out that the current system is based on a market-oriented approach rather than prescribing specific security of supply standards. In this way, it is difficult to measure what level of security of supply we have.

- Nick Wye pointed out that he has no problem with Ofgem's approach to utilise the EU security of supply standard. However, he questioned what measures should be used to achieve that standard. He noted that a certain 'leap of faith' was required.

- Ian Marlee agreed that for any market based approach some leap of faith is inevitably required.

- Eddie Proffitt pointed out that the calculated probabilities are not of major importance. If demand is very high and infrastructure was to fail, then we would be in an emergency.

Question 3: One attendee noted that in his view Ofgem has already decided that it will implement its proposed cash-out reform. He also pointed out that the investigation of further interventions might undermine the case for cash-out reform. In particular, he raised the question as to why we are investing time and money on cash-out reform if further interventions might be implemented in the future. He further pointed out that £20 per therm might not be necessary since shippers would already supply as much as possible at prices such as £2 per therm.

Responses:

- Ian Marlee stressed that Ofgem has not made up its mind and that this is a consultation process. He emphasised that Ofgem wants people to engage in the process and provide detailed comments. In particular, several questions are addressed to stakeholders in the draft policy decision. He further pointed out that it is not about whether £2 is sufficient to attract gas. It is about providing the incentives for companies to take long-term measures to enhance security of supply. This is particularly relevant in times of depleting domestic reserves since the Network Emergency Coordinator can only instruct the flow of domestic reserves in an emergency. In addition, even if further interventions were introduced, Ofgem believes that the market should be doing as much of the heavy lifting as possible and hence, there is still a role for cash-out reform.

- Nick Wye supported the view that we should wait to implement cash-out reform until we know the outcome of the work on further interventions. He also noted that he has identified different views from industry on whether shippers would flow gas at £2 per therm even if they know that cash-out will go up to £20 per therm. He suggested that feeding VoLL into cash-out might not be the right answer.

- Vladimir Parail pointed out that in a situation of high demand and high prices in Europe, additional gas is more likely to be imported at £20 per therm than it would be at a lower price.

Question 4: It was noted by one attendee that the reforms will put up consumer prices and increase fuel poverty and it was therefore questioned whether we can afford this reform now.

Response:

- Ian Marlee noted that the risks already exist but that they are with consumers and not with those best able to manage those risks. He pointed out that the modelling does not indicate a material impact on consumer prices.

- Eddie Proffitt pointed out that he is in favour of cash-out reform and involuntary demand side response (DSR) payments at £20 per therm but he questioned whether industry could afford it.

Question 5: In response, one attendee suggested that the impact on consumer bills would not be tiny but would appear to be manageable. This attendee was more concerned with the short term impacts on domestic consumers in the event of an emergency and asked who would look after domestic consumers if their gas supply was cut off due to an emergency.

Response:

- Ian Marlee noted that as payments will only be provided to interrupted firm customers for the first day of any domestic customer interruption these customers are still likely to incur costs for all subsequent days of an emergency. He noted that this is one of the reasons for considering further interventions alongside capped cash-out.

- With regards to impacts on bills he suggested that the extent to which bills will be impacted is dependent on the extent to which industry is now taking out sufficient insurance against an emergency. If the changes put in place show that industry is currently not taking out sufficient insurance then the proposed cash-out reform will have a greater impact on bills. If industry is already insuring against an emergency to a large extent then impacts on bills will be lower.

- Eddie Proffitt stated that he struggled to see how cash-out reform could cost an extra £6 per bill per year since the cash-out price would only increase to £20 per therm if an emergency occurred. He also voiced the opinion that shippers and suppliers may not believe insurance to be worth the premium and may simply take the risk.

- In response it was clarified that the figure of £6 per bill per year was for capped cash-out in addition to the further intervention modelled (ie one form of storage obligation). The impact on bills for capped cash-out alone was estimated to be £0.16 per bill per year.

Question 6: Another attendee highlighted that consumers will only get a payment in the event that they are interrupted due to a gas deficit emergency but that they would have to pay every year for the additional security of supply. The attendee also suggested that care must be taken when interpreting the results of modelling which can be very difficult to get right.

Response:

- This question provided Ian Marlee with the opportunity to highlight that Ofgem are seeking stakeholder views on how interruptible contracts might work alongside the proposed cash-out reform. In particular, Ofgem are keen to assess whether option payments – that is, a regular reduction on gas bills in return for being interruptible (possibly alongside a payment when the interruption occurs) – would encourage large industrial and commercial firm customers to sign interruptible contracts.

- He voiced Ofgem's view that while incentivising suppliers to provide reasonable terms for interruptible contracts, consumers would not be able to hold suppliers to ransom given the other options available for insuring against an emergency and given the low probability of an emergency occurring.

- He also suggested that those customers with a high VoLL would be unlikely to sign an interruptible contract but that this would make sense given the fact that if they were interrupted they would receive payments at an amount closer to their valuation of the gas.

- Eddie Proffitt suggested that a good place to start researching the potential for interruptible contracts would be with the distribution network companies who have information on who would be interrupted first in the event of an emergency. He added that the Distribution Networks have carried out interruptible capacity auctions for the past three years. Eddie suggested that in year one there was a clear indication of the value consumers placed on interruption particularly as most bids were rejected.

Question 7: It was suggested that the draft policy decision went into adequate detail regarding how cash-out would work but was less detailed with regards to the interruption payments process. They voiced concerns with the possibility of a balanced shipper having to pay in the event that a short shipper is not able to cover its payment requirements and enters bankruptcy. The attendee asked how this interruption payments process could be put in place.

Response:

- Ian started by highlighting that we are doing further work on this issue and that we realise that there are credit risks which are currently socialised across the industry if an indebted party fails.

Question 8: One attendee voiced concern that we were in danger of 'analysis paralysis'. They suggested that if we believe the markets are not delivering the desired security of supply then the only way to achieve this would be to increase physical gas reserves through some form of further intervention. Another attendee added to this by asking if we had considered the arrangements in other countries of north-west Europe when developing our proposals.

Response:

- Eddie Proffitt responded by suggesting that strategic storage had previously been considered an expensive option.

- In response, the attendee pointed to public service obligations rather than strategic storage. They asked how this option would be implemented and suggested that it would lead to additional storage.

- Ian Marlee responded to the concern of 'analysis paralysis' by indicating his belief that our proposals were in essence fairly simple. He indicated the 'free system actions' available to relieve an emergency by disconnecting firm load customers without providing any form of payment for this. He stated that our proposals are attempting to put price signals in place so that the market can do as much as possible first before considering the case for further interventions to fill any remaining gap that is identified.

- Finally, he stated that we have seen prices up to £2 per therm previously but that no data is available on an emergency as none has ever occurred. However, rather than waiting for an emergency to occur so we can identify what we should have done, we are looking to be pro-active and avoid one arising in the first place.

- Ian replied in response to the question of considering arrangements in other markets by confirming that we had looked into this but that there are few comparators to the GB market. He added that we are also considering the EU Security of Supply Regulation and the potential for public service obligations through the further interventions work stream.

- Nick Wye voiced his concerns that the proposals may lead to unintended consequences through the application of the cap on cash-out at VoLL which could distort the market.

- Nick Wye added that by proposing to implement capped cash-out with the addition of further interventions Ofgem are already identifying the inefficiency of the capped cash-out proposals. This led him to ask the question of whether we need capped cash-out at VoLL and further interventions or just one or the other. He repeated his message that it is important to consider the options holistically rather than considering capped cash-out and further interventions each in isolation.

Attachment 1 — list of attendees

Name	**Organisation**
Adrian Raison	Total
Alex Whitmarsh	Ofgem
Alison Meldrum	Tata Steel
Amrik Bal	Shell Energy Europe Ltd
Andrew Malins	National Grid
Andrew Green	Total Gas & Power
Andrew Pester	Ofgem
Anna Barker	Ofgem
Antony Miller	Centrica
Bruno Leray	Storengy UK
Catherine Leiper	Total Gas & Power Ltd
Charles Ruffell	RWE npower
Chris Le Fevre	Le Fevre Consulting
Chris Wright	Centrica
Clare Cantle-Jones	Energy Networks Association
Claire Thorneywork	National Grid
Christiane Sykes	Statoil (UK) Ltd
David Cox	London Energy Consulting Ltd
David Evans	BG Group
David Odling	Oil & Gas UK
Dora Ianora	Ofgem
Duncan Sinclair	Redpoint Energy
Ed Stafford	DECC
Eddie Proffitt	Major Energy Users Council
Federica Maranca	Eni
Fiona Strachan	Gazprom
Gareth Davies	Chemical Industries Association
Gerry Hoggan	Scottish Power
George Grant	Stag Energy
Giles Stevens	Ofgem
Ian Marlee	Ofgem
Jeff Chandler	SSE
John Costa	EDF Energy
Julie Cox	Association of Electricity Producers
Karen McDonough	HSE
Lee Millard	Interconnector (UK) Ltd
Lewis Heather	Ofgem
Malcolm Arthur	National Grid
Mark Cockayne	xoserve
Marshall Hall	BG Group
Michael Dodd	ESBI
Mike Potter	HSE
Nick Reeves	National Grid
Nick Wye	Waters Wye Associates
Paul Youngman	National Grid
Richard Fairholme	E.ON
Richard Sarsfield-Hall	Pöyry Energy Consulting
Richard Street	Corona Energy
Roddy Monroe	Centrica Storage
Sandro Fuschillo	ENI
Simon Trivella	Wales & West Utilities Ltd
Simon Witter	ENI

Sonia Youd	Halite Energy
Sophie Neuberg	Consumer Focus
Steffen Felix	Ofgem
Sukhinder Lalli	Ofgem
Vladimir Parail	Redpoint Energy