

# **Draft Policy Decision on the Gas Security of Supply – Significant Code Review**

## **Opening stakeholder seminar**

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## Purpose of presentation

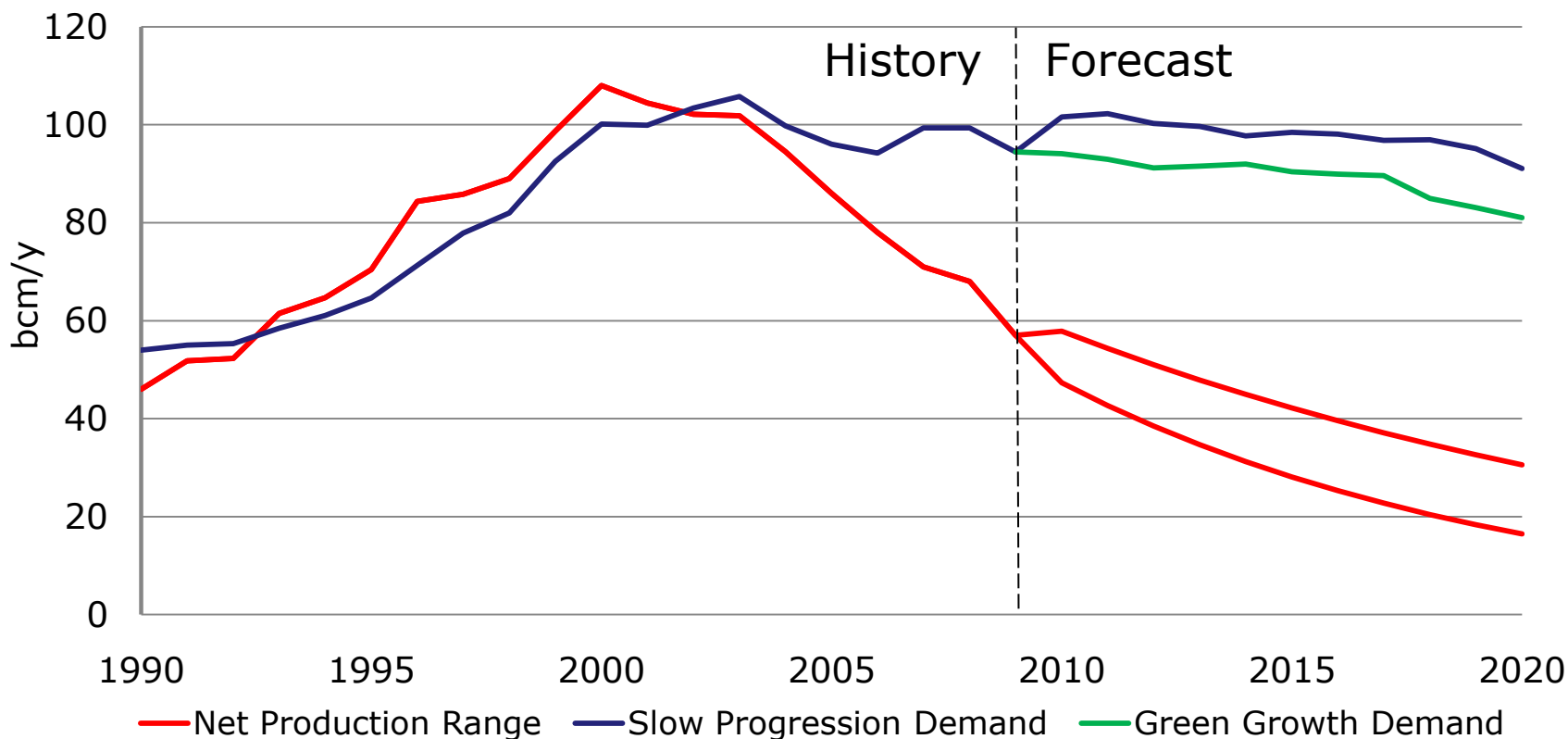
- 1. Recap on the purpose of the Gas SCR**
- 2. Process to date**
- 3. Outline the draft policy decision**
- 4. Next steps**

# 1. Purpose of the Gas SCR

- Why are we doing it?
- Why now?
- What are our key objectives?

# Why are we doing it?

- For some time we have expressed concerns about whether the current arrangements can ensure security of supply into the future
  - Increased import dependency increases these concerns



Source: National Grid, Ten Year Statement, 2010

## Why are we doing it?

- Cash-out prices incentivise shippers to balance supply and demand
- But cash-out is frozen at stage 2 of a gas deficit emergency (GDE)
- Project Discovery highlighted concerns that a frozen cash-out price may not attract gas during a GDE and may not provide sufficient incentives to invest in security of supply
- Interrupted firm customers do not get paid for the involuntary demand side response (DSR) services they provide to manage a GDE
- **The costs and risks of a GDE are mainly with consumers despite industry being better able to manage these risks**

## Why are we doing it?

- New Significant Code Review (SCR) process allows holistic approach to reviewing code-based issues
- Government priority
  - New statutory power to facilitate reforms through the Energy Act 2011
- 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 interrupted

## 2. Process to date

- What have we done so far?
- How did stakeholders react to the initial consultation?
- What is our response to stakeholders' feedback?

## What have we done so far?

- Initial Consultation published on 11 January 2011
- Two seminars and three workshops between January and April 2011, discussions with key stakeholders throughout
- Six consumer panel discussions were held in January and February to elicit the views from domestic consumers across GB
- Study by London Economics on the “Value of Lost Load”
- Quantitative modelling by Redpoint Energy to assess the costs and benefits of reform proposals
- Draft Policy Decision and Draft Impact Assessment published on 8 November 2011



## Stakeholder feedback to initial consultation

- Broad support for the Gas SCR despite general view that the gas market has shown its resilience to date
- Need for more time to assess and consult on all options with all stakeholders (no “exclusive” workshops)
- No clear preference for any reform option included in the initial consultation. Support for investigation of other reform options, eg enhanced DSR mechanisms
- Enhanced obligations were broadly opposed by shippers but supported by large users and storage operators
- Concerns around changes to the safety case with respect to the role of the National Emergency Coordinator

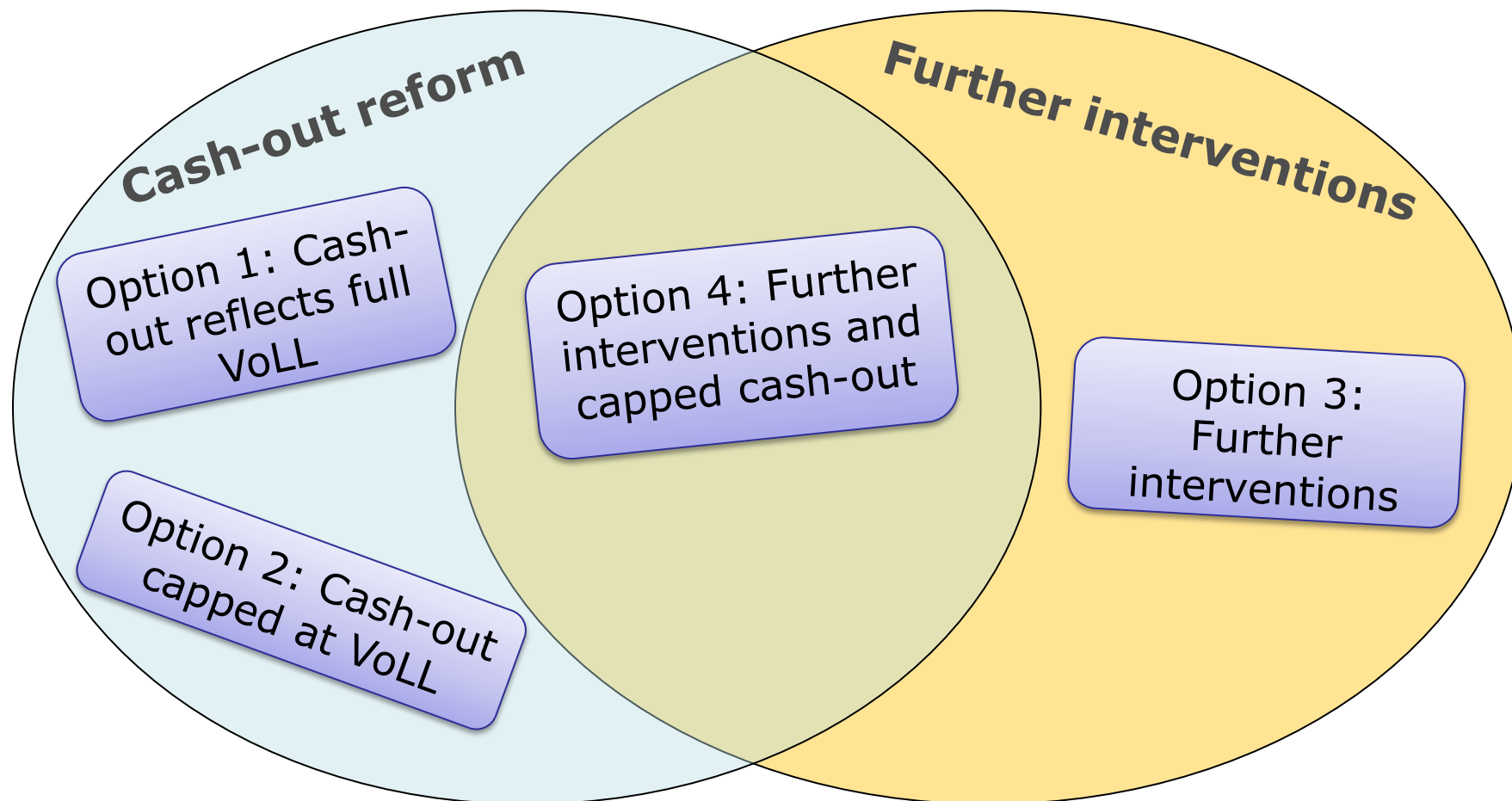
## Our response to stakeholder feedback

- The arrangements have worked well to date BUT we remain concerned that risks are mainly with consumers particularly in times of depleting domestic reserves
- We have developed our reform options further and attempted to enhance the process as a result of stakeholder feedback by
  - allowing additional time to assess and consult on the reforms (consultation period is now 12 weeks) with all stakeholders being invited to the workshops
  - broadening the scope of enhanced obligations to include other interventions – now called ‘further interventions’ (eg DSR auction, standard interruptible contracts, etc)
  - further developing the cash-out proposals to address concerns around the safety case and impacts on shippers

## 3. Our draft policy decision

- What are our revised reform options?
- What is the Authority's draft policy decision?
- What is the draft policy decision based on?

# What are the revised reform options?



## What are the revised reform options?

### Option 1: Cash-out reflects full VoLL

- The cash-out price would rise to domestic VoLL for each day of firm load shedding and to a multiple of VoLL for the first day of any new physical network isolations
- London Economics (LE) estimated VoLL for domestic customers – we are proposing a notional VoLL of £20/therm
- Firm customers receive payments for their involuntary DSR services at the level of cash-out (ie VoLL for each day of load shedding, and a lump sum multiple of VoLL for physical network isolations)

## What are the revised reform options?

Option 2: Cash-out  
reflects capped VoLL

- Allowing cash-out to reflect the full costs of domestic VoLL could impact competition and have unintended consequences
- Option 2 could address these concerns by capping cash-out
- Cash-out will rise to domestic VoLL for each day of firm load shedding and the first day of new physical network isolations
- Firm customers receive payments for their involuntary DSR services at the level of cash-out (ie for all days of firm load shedding and for the first day of physical network isolation)

## What are the revised reform options?

### Option 3: Further interventions

#### Examples:

- Technology non-specific interventions including
  - information obligation
  - reliability options
  - a proof of winter supplies obligation
  - licence condition to ensure domestic customer demands are met
- Demand side interventions including
  - standard interruptible contracts
  - a demand side response auction
- Storage interventions including new build of a regulated or semi-regulated storage facility, a storage obligation or strategic storage

## What are the revised reform options?

### Option 4: Further interventions and capped cash-out

- Combines options 2 and 3
  - Cash-out and payments for involuntary DSR services are capped
  - Further interventions are introduced to supplement capped cash-out



## Draft policy decision

- The Authority is minded to pursue option 4 to:
  - implement cash-out reform capped at one day's domestic VoLL
  - recommend more consideration of possible further interventions alongside cash-out reform
- The Department of Energy and Climate Change (DECC) has asked Ofgem to investigate further interventions
  - Ofgem will submit a report to DECC by May 2011
- The remainder of the consultation for the Gas SCR will focus on our proposed cash-out reform
  - Responses on further interventions are invited and will be addressed as part of the new further interventions work stream

# What is the draft policy decision based on?

Key criteria	Current arrangements (frozen cash-out)	Option 1 Cash-out rises to full VoLL	Option 2 Cash-out rises to capped VoLL	Option 3 Further interventions with frozen cash-out		Option 4 Further interventions with cash-out rising to capped VoLL	
				Best	Worst	Best	Worst
Likelihood of firm outages							
Duration and severity of outages							
Payment for involuntary DSR services							
Consumer prices							
Competition and Market Efficiency							

Positive impact    
 Moderate impact    
 Negative impact

## What is the draft policy decision based on?

### Probability of interruptions in years

Options	Interruptions of firm daily metered customers	Interruptions of firm non-daily metered customers
Current arrangements	1 in 16	1 in 122
Option 1: Cash-out rises to full VoLL	1 in 67	1 in 303
Option 2: Cash-out rises to capped VoLL	1 in 63	1 in 182
Option 3: Further interventions (using storage example)	1 in 15	1 in 588
Option 4: Further interventions (using storage example) with cash-out rising to capped VoLL	1 in 175	1 in 2000

## What is the draft policy decision based on?

- While option 1 places the risks with those best able to bear them, we have concerns about its credibility, impact on competition and potential for unintended consequences
- Modelling suggests that capped cash-out can still attract gas in a GDE though there will be less insurance against a GDE occurring
- Combining capped cash-out and further interventions can bridge the gap created by capping cash-out and deal with other potential concerns – depending on the choice and design of further interventions
- The costs and benefits of the various further interventions vary depending on type and design
  - More work is required to investigate this further

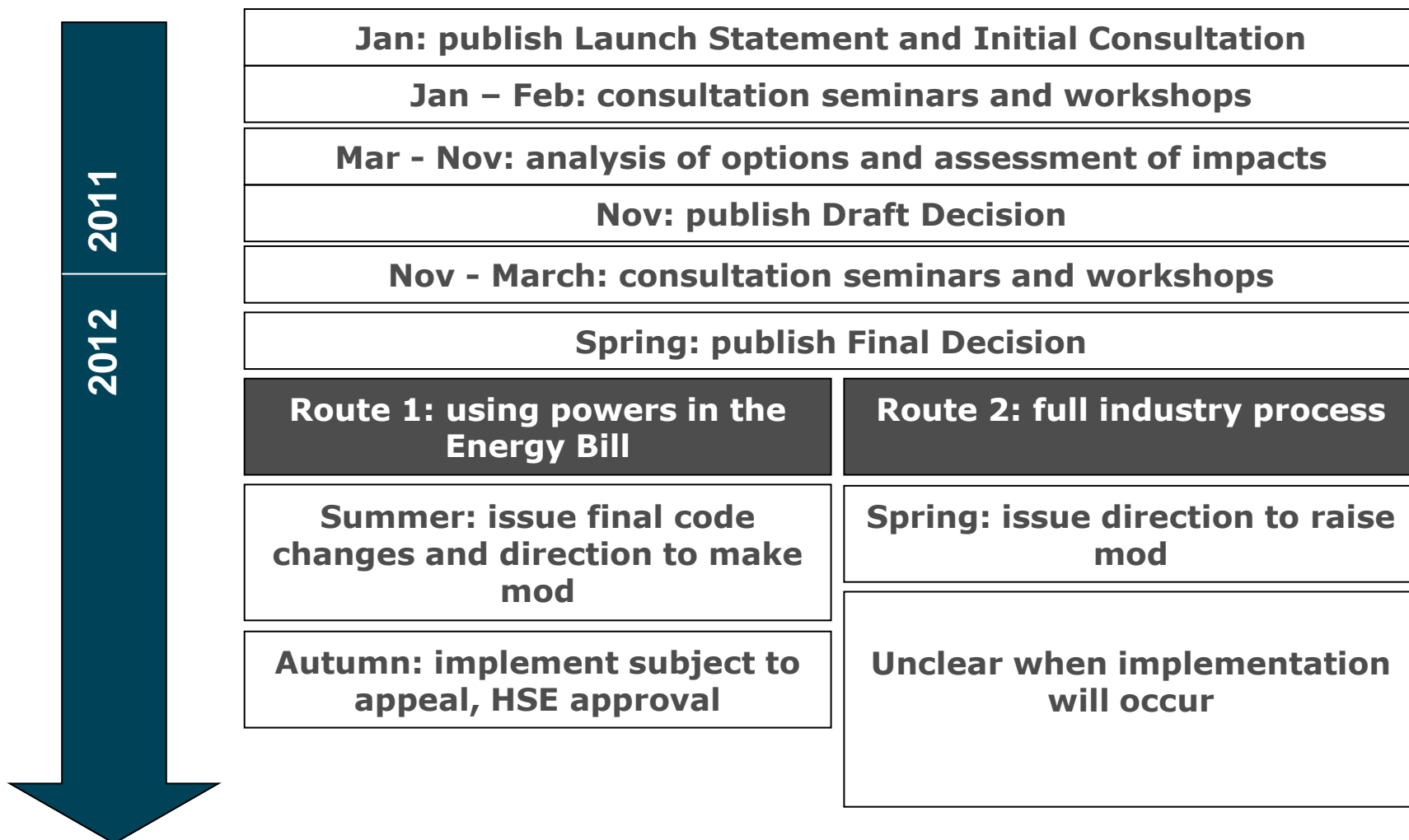
## Further interventions work stream

- DECC has asked us to investigate the broader risks to gas security of supply in GB
- As part of this we will be investigating whether further interventions are required and if so, what these should be (taking into consideration their costs and benefits)
- We are planning to hold a number of stakeholders events in the new year
- We will deliver a report to DECC in May 2012

## 4. Next steps

- How and when are we planning to take this forward?
- How are we planning to involve stakeholders?

## Indicative timetable



## Further stakeholder engagement

### Consultation on draft policy decision

Event	Date
Opening stakeholder seminar	Today
Workshop 1	13 December 2011
Workshop 2	23 January 2011
Deadline for responses	31 January 2012

### Licence and code drafting

Event	Date
Workshop 3	15 February 2011
Workshop 4	29 February 2011
Closing seminar	14 March 2011



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*

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