ofgem

Minutes

Gas Significant Code Review — Draft Policy Decision Workshop 2

Date: Monday, 23 January 2012
Time: 10:00 – 12:30
Location: 9 Millbank, London

1. Opening presentation

1.1. Lewis Heather of Ofgem opened by outlining that the main purpose of the workshop was to go through the two sets of business rules developed by National Grid Gas (NGG) to implement Ofgem's Draft Policy Decision on the Gas Security of Supply Significant Code Review (Gas SCR). Lewis pointed out that NGG and Ofgem have developed these proposals for a near term and post event option because stakeholders asked at the last workshop for more detailed proposals on specific implementation issues. He noted that the business rules were being presented for the purposes of encouraging discussion at this stage and that these business rules would be worked up following discussion.

1.2. The group was subsequently divided up into two break-out groups. Both groups discussed the same issues. NGG presented the business rules for the near term and post event options in both work groups.

2. Break-out session 1

2.1. NGG began by outlining the current emergency cash-out process. It was highlighted that a Gas Deficit Emergency (GDE) is likely to be an extremely rare event, and it was important to discuss whether it was better to attempt to fit the Gas SCR proposals into the current framework as best as possible, or to amend the existing processes to make them more suitable to accommodate the Gas SCR proposals.

2.2. The group discussed the accuracy of data in relation to Non Daily-Metered (NDM) sites, and the trade off between time taken to obtain the data and the accuracy attainable. Two options were described. The first involved making a best estimate of the NDM sites isolated (and associated demand reduction) as near to the event as possible and calculating imbalances on this basis. Once the information on isolated NDM sites could be verified, there would be a reconciliation process to correct for any inaccuracies in the original information. The alternative option was to wait until all information was known before calculating imbalances post-event. It was argued that, for the industry as a whole, it was preferable to know which shippers are short as near to the event as possible, even if this was to be based on data that could not be guaranteed to be 100% accurate. There was general agreement that a "near time" option was preferable, subject to the estimates for NDM sites being reasonably accurate. It was stated that accuracy of these near-time estimates would be in the region of 90 per cent or higher.

2.3. The group considered the impact of NDM customer interruption on a shipper's imbalance position. There was concern that, once the effect of NDM demand reduction was taken into account, all shippers would appear long, even if they had under-delivered gas relative to their demand portfolio and hence were partly responsible for the need to isolate NDM demand. The general thought was that it would seem appropriate to have a process for NDM customers similar to the Emergency Curtailment Quantity (ECQ) process for Daily Metered (DM) customers (or else remove the ECQ process for both DM and NDM customers). Concerns were expressed that, for shipper instructed demand interruption, this could lead to an argument between NGG and shippers as to who was first to instruct off a particular customer and whether the volume should be included in the calculation of market position.

2.4. NGG talked through the assumptions behind the business rules for the two options ("near-time" and "post-event"). They then compared the timescales for the two options versus the current process. A comment was made that freezing the cash-out price for long shippers (at the system marginal sell price "SMP sell") may reduce incentives to bring imported gas into the country.

2.5. The group discussed whether the current payment terms were appropriate, or whether there was merit in considering extending the timescales to allow shippers more time to raise finances if necessary to pay the invoice.

2.6. It was noted that both options for the business rules would be developed, and presented to Xoserve for an estimate of the cost of implementing each option. These costs would be taken into account in determining which option to pursue.

2.7. Ofgem then presented some issues that were discussed at previous workshops but were not brought up as part of the discussion of the draft business rules at this workshop.

2.8. Ofgem noted that the business rules as drafted assume that the cash-out price for long shippers is unchanged from the current arrangements. However, Ofgem stated that there may be merit in considering a single cash-out price for both short and long shippers and welcomed views on the merits of the two options. Arguments were made in favour of a single cash-out price, to improve incentives on long shippers to bring imports into the country, but this was on the condition that cash-out was not capped at the Value of Lost Load (VoLL – currently estimated to be £20/therm) and instead allowed to float. The argument was that dynamic cash-out would allow the market to find its own level, which would be likely to be below £20/therm. There were additional concerns that VoLL could create a target price for shipper-to-shipper trading. Some thought this would lead to increased risk of prices rising faster and higher. Although the current arrangements could lead to a price in excess of VoLL, it was thought that this is unlikely. There was some concern that the proposals would make it more likely that cash-out price would rise to a very high level, as VoLL could act as a target price.

2.9. Ofgem outlined its "minded-to" position on interruptible customers who are instructed off by NGG. This position was that customers would receive the exercise price, as per the terms of their contract. Shippers would not be provided with a payment to pass through with respect to demand-side response (DSR), but would instead benefit from improvement in their imbalance position. As a result, NGG would not apply the ECQ process to these volumes. A question was raised as to whether this would require NGG to know full commercial details of all interruptible contracts. Ofgem responded that this would not be necessary as this would be enacted through a licence condition on shippers and/or suppliers. In this way, it would be necessary for NGG to know which customers held interruptible contracts, but it would not be necessary for NGG to know any of the commercial details.

2.10. In respect of firm load shedding of NDM customers, Ofgem outlined the options as to who should be obliged to prove that the load shedding had actually taken place. The two options were for the burden of proof to fall on either customers or suppliers. As customers have the option to purchase their own Automated Meter Readers (AMRs), members of the group argued that the burden of proof should fall on customers. This is because there is no guarantee that suppliers will have access to data from the AMR if it has been procured by the customer rather than fitted by the supplier. However, it was argued that the customer should always be able to access data from their AMR.

2.11. Ofgem raised the issue of force majeure (FM), and outlined its minded to position that FM should not apply to the cash-out mechanism nor to involuntary Demand Side Response (DSR) payments. This was because it would reduce incentives to attract gas imports before and during an emergency, and create disincentives to insure against an emergency. Participants expressed concerns that this would weaken trading at the National Balancing Point (NBP), as shippers would be unwilling to bring physical gas to trade as they would be forced to bear the risk if FM was exercised in their upstream supply contracts. It was also argued that this could cause some companies to set up "shell companies" to ship gas from the beach to the NBP, which would be designed to fail in the event of an emergency.

2.12. Ofgem outlined its minded-to position that rules for dealing with insolvency are out of scope of the Gas SCR, and it is for industry to determine whether existing arrangements are appropriate.

3. Break-out session 2

3.1. The group discussed whether it would be better to have a "rough" estimate of shippers' imbalances early on and a reconciliation process thereafter or whether it would be better to wait for all the information to be available to calculate imbalances. There was general consensus in the group that it would be better to go for a near-term option to identify more quickly the rough imbalances of shippers. While this might have adverse credit implications for individual shippers, it was argued that for the industry as a whole it would be advantageous to know early on which shippers might be affected. It was also argued that for consumers it is important to receive the money as early as possible to avoid bankruptcy of gas consuming businesses. However, it was also pointed out that even for a post event option, the System Average Price (SAP) could be payable in the short-term (in effect revealing the estimated imbalances of shippers), giving shippers longer to finance their imbalance once this is calculated accurately using VoLL. It was also noted that both options would have different cost implications that need to be taken into account. Therefore, implementation costs (mainly costs to change Xoserve's systems and processes) would need to be assessed for both options and compared to the benefits that the options would bring.

3.2. Participants asked how long shippers would be funded since cash-out payments from short shippers would be paid to fund payments for demand side response (DSR) services. There was also a general question why Ofgem uses the term involuntary DSR payments rather than compensation. Ofgem responded to both questions by outlining that long shippers would still get funded using funds from short shippers. The involuntary DSR payments were introduced to acknowledge that interrupted customers are in essence providing a similar service as long shippers. The example was given that if short shippers are 10 units short and long shippers are 5 units long and customer consumption has to be curtailed in the order of 5 units, then the cash-out payments from short shippers would be used partly to pay long shippers and partly to pay interrupted customers. However, there might be an imbalance which could either be targeted at short shippers or go through the neutrality mechanism (if the frozen SAP is below VoLL, the imbalance could be positive but if more customers have to be interrupted for safety reasons then the imbalance could be negative). Ofgem noted that the term "payments for involuntary DSR services" has been used to reflect the fact that once firm customers have their demand curtailed they are providing a balancing service as much as other market participants (eg long shippers) are. Hence, they should be paid for this.

3.3. It was believed that working out the lost load for DM customers and large NDM customers should be fairly straightforward since the ECQ (or similar) processes can be used. For smaller NDMs this might be more difficult and some assumptions would have to be made – at least until smart meters are rolled out - around their average consumption. An issue remains around allocating interrupted NDM customers to shippers.

3.4. There was some discussion around the stages of an emergency and whether it is possible to move from a stage 2 to a stage 3 and back to a stage 2 emergency or whether the system would have to move to a stage 5 (restoration phase) emergency first. It was argued by some that a local gas emergency would be declared subsequently if there was enough gas in the system but if some parts of the network were still isolated and in the process of being restored. In these cases, there was a question about whether this would impact cash-out reform and involuntary DSR payments. NGG agreed to clarify this issue.

3.5. It was pointed out that under both options, the monies required to fund interrupted firm customers must be collected before customers can be paid for their involuntary DSR services. Otherwise this would create cash-flow problems for the industry. However, it was argued by consumer representatives that this could take weeks or months and that gas consuming businesses could go out of business in the meantime.

3.6. There was also some discussion as to whether the incentives on transporters were right to ensure that they reconnect customers as quickly as possible. Ofgem argued that this was out of scope of the Gas SCR.

3.7. One attendee questioned whether shippers would be guaranteed the price they demand when bringing in gas in an emergency. Ofgem responded that short shippers should be willing to pay up to £20 per therm for this gas. However, if a shipper claims that it needs more than £20 per therm to cover the opportunity cost of having supplied the additional gas, this would go through the Post Emergency Claims (PEC) process with the top 20 per cent of claims being assessed by Ofgem.

3.8. After discussing the business rules, Ofgem presented several slides on other issues that were not yet covered in the business rules. Due to time constraints these issues were only covered briefly but Ofgem invited stakeholders to respond to the “minded-to” positions as part of their formal consultation responses.

3.9. The group discussed the issue of introducing a single cash-out price (ie the cash-out price for long shippers being the same as the cash-our price for short shippers; that is, set at VoLL rather than frozen SAP). Some participants pointed out problems with having such a single cash-out price, in particular the risk of reducing market liquidity. No one argued in favour of a single cash-out price. There was however some discussion as to whether the cash-out price for long shippers should be dynamic SAP rather than frozen SAP. NGG pointed out that even the frozen SAP price is to some degree dynamic since it takes PEC claims into account.

3.10. The level of payment that interruptible DM consumers should receive should they be instructed to come off by transporters rather than by their suppliers was discussed. Ofgem’s minded to position on this is that suppliers pay customers the contractually agreed exercise price and that shippers would benefit from becoming longer. Hence, the ECQ mechanism would not apply to interruptible customers. A consumer representative argued that customers should receive VoLL if interrupted by a transporter since the purpose of an interruptible contract is to avoid a GDE but if a GDE occurs, interruptible customers should be treated as firm customers.

3.11. On the issue of how to prove that large NDM customers have curtailed their load when asked to interrupt by a transporter, Ofgem presented two options: the burden of proof could either be on consumers or suppliers. One participant argued that the burden should be on transporters. Ofgem however pointed out that the obligation to roll-out AMRs by 2014 is currently on suppliers and that transporters would have no incentive to prove that customers have curtailed their load.

3.12. Regarding FM, Ofgem put forward their position that this should not be introduced in the cash-out mechanism and should not apply to involuntary DSR payments.

3.13. Ofgem also stated its belief that the issue of whether the insolvency arrangements are appropriate is out of scope of this review.

4. Reporting back

4.1. Both groups reported back on their discussions. Lewis thanked participants for their contributions during the break-out sessions and emphasised the importance of consultation responses on this complicated issue (due 31 January 2012). The next workshop on codes and licence drafting will take place on 15 February 2012.