



CHEMICAL INDUSTRIES
ASSOCIATION

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Gas Security of Supply Significant Code review (SCR) – Ofgem Draft policy Decision

Response from Chemical Industries Association

The Chemical Industries Association¹ welcomes the chance to respond to this consultation especially as our membership not only use a large amount of gas for direct firing, but also as a feedstock for a number of chemical processes. It is essential that our members enjoy secure, competitively priced energy if they are to continue to invest in manufacturing plant in the UK.

We fully support Ofgem's proposals to transfer gas supply risk away from gas consumers and on to suppliers. We also welcome the initial decision of rewarding firm gas customers with a set value of VOLL if supplies are interrupted. Although a step in the right direction we still have a number of reservations as to the outcome of the proposed changes and have summarised our concerns below;

Greater physical not financial security – Our underlying concern is that the arrangements as proposed will lead to financial and not greater physical security of the gas market. It is clear that the proposals as set out will expose suppliers to higher cash-out prices; however suppliers readily highlighted during the SCR workshop that a potential mechanism to mitigate this risk is to generate an insurance pot through increased energy prices. Ultimately the end consumer is going to have to pay for increased long-term security, however increased costs should be used for increased physical assets (that make an emergency less likely) not one of payments to disconnected consumers.

Demand Side Response - While it is not possible for all of our members to actively participate in demand side response, be it due to the nature of specific chemical processes, HSE or the large intensive nature of some sites. We believe there are opportunities for a select number of chemical sites to offer interruptible services in the future. For example, there are members of the CIA who offered demand side response pre-UNC Modification 90 and subsequently are not offering any interruption services following the regime change. Whilst we support the theory that increased cost exposure for suppliers may incentivise them to offer more demand side response

¹ With an annual turnover of £60 billion, chemical businesses in the UK are a key contributor to the economy. Every working day, our sector adds £30 million to our country's balance of trade. The jobs of 600,000 workers in the UK depend on chemical businesses.

contracts. We have reservations that this scheme may not incentivise suppliers to increasingly engage with end consumers to negotiate demand side response services. This point was backed up by comments made by suppliers in workshops, noting short supply contracting periods as one of the barriers.

A holistic view of future provisions - We welcome the commitments by Ofgem, and support of DECC, to investigate the requirement for further interventions. We see this as key to ensuring adequate future security of supply above and beyond the provisions already highlighted for cash-out reform. As highlighted by the comments already made, we have concerns that the cash-out reforms alone will not result in a more secure market and will not meet the primary objective of minimising the likelihood of a Gas Deficit Emergency. ***We believe it is necessary to assess the provisions to secure gas supplies in a holistic way once the assessment of further interventions has been made.*** A future assessment of both market based mechanisms and further interventions would be consistent with Ofgem's work on electricity - with the electricity cash-out consultation being delayed until the wider Electricity Market Reform policy decisions had been made. The CIA has already indicated its willingness to participate in meetings with Ofgem to input into this work and look forward to feeding in comments once the assessment of global gas supply risks has been completed.

Following our general comments please find answers to those questions where we feel we have the expertise to answer.

Chapter 3: Level of security of supply

Question 2: Do you agree with our approach to setting the level of security of supply?

It seems sensible that the UK security of supply level is consistent with that set out in the EU Gas Security of Supply Regulation. We do however have reservations as to whether a VOLL set at £20/therm equates to this and readily proves that the UK is in line with the regulation.

Chapter 4: Cash-out reform

Question 7: Will enhanced incentives to avoid an interruption occurring increase the number of interruptible contracts entered into by industrial consumers? Please explain why.

As already highlighted under our general comments - We have reservations that this scheme may not incentivise suppliers to increasingly engage with end consumers to negotiate demand side response services. This point was backed up by comments made by suppliers in workshops, noting short supply contracting periods as one of the barriers.

Chapter 5: Possible further interventions

Question 1: Do you agree with our assessment that a gap in the emergency arrangements would remain following the introduction of capped cash-out? If so, to what extent do you believe that this gap can be overcome through further interventions?

We have reservations as to whether capped cash-out will ultimately result in a more secure gas market. Having already voiced our concerns that the proposals may result in an “insurance pot” we fully agree that further interventions are required to ensure that there is more physical assets securing the gas market.

Chapter 6: Assessment of options

Question 3: Do you agree with our assessment on a preferred option?

Having expressed the desire for an assessment of further interventions on top of a cash-out VOLL we see Option 4 as the most appropriate.

Appendix 3: Further interventions

Question 1: Do you have a preference for a specific intervention/s that you think might be most effective for ensuring security of supply while minimising the risks and unintended consequences?

We look forward to engaging further in workshops and discussions with Ofgem (as indicated at the end of last year) that will take place in assessing the role of further interventions. We hope that the initial gas supply risk assessment is transparent and communicated to all market participants before looking at possible interventions. As highlighted in our general concerns we support interventions that will increase physical assets in the UK.

Question 2: Do you think that standard contracts combined with cash-out reform provide the necessary incentives for suppliers to increase penetration of contracts for interruption?

Whereas standard contracts may help provide a basic framework, we would be against a process that may inhibit any flexibility in contracts. Ultimately there must be enough flexibility to allow consumers the confidence to sign contracts without detrimental effect on their production.

Question 3: A number of stakeholders have suggested an auction for interruption. We outline several challenges with such an approach and are keen to hear proposals on how to overcome these challenges.

There have been some initial discussions within Ofgem meetings around possible auctions for interruptions. One such discussion centred on the ability of end consumers to bid in to an auction and whether companies that unsuccessfully bid, or did not bid into the process at all, should receive payments if interrupted on a firm contract. We would like to stress that it is not possible for all of our members to actively participate in demand side response, be it due to the nature of specific chemical processes, HSE or the large intensive nature of some sites. These sites should not be penalised because of the nature of their business and should still be part of the process of transferring the risk away from consumers and on to suppliers.

Question 4: If some kind of storage obligation was to be implemented, do you favour an obligation on suppliers or shippers? Alternatively, do you think the system operator or government should invest in strategic storage or build storage facilities for the industry to use?

We would support an Ofgem workshop as part of the further intervention work specifically to discuss the merits of gas storage and the ability to incentivise adequate amounts in the UK. The CIA looks forward to engaging further with Ofgem in this area.