Consultation Questions

CHAPTER 3: Level of security of supply

Question 1: Are there any options for determining the level of gas supply security to be delivered by the market that we have not considered?

To reflect current forecasts* that the UK will be importing 70% of its gas supply by 2020 with, at the same time, low carbon targets being met by offshore wind demanding large additional gas deliverability to back up periods of winter anti-cyclonic windless weather, a more stringent level of security of supply should be applied than that used historically.

For example, mirroring the French approach to gas supply security for the UK might entail examining gas supply security when the major supply source was disrupted for 6 months, combined with a need for gas for generation to back-up large volumes of offshore wind generation during a static anti-cyclonic windless weather pattern remaining over North West Europe for a two week period in winter.

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

No, for the reasons outlined in our answer to question 1

* National Grid 10-year Statement 2011

CHAPTER 4: Cash-out reform

Question 1: Do you agree that it is appropriate to retain the Post Emergency Claims (PEC) arrangements? If not please explain why.

Yes it is appropriate to retain PEC

Question 2: Do you agree with how we have estimated Value of Lost Load (VoLL) and the level of VoLL that we have used? Is there a case for using a higher VoLL to incentivise more discovery of the demand side?

In order for the market to function properly in this regard we believe the cash-out price should be left uncapped during Stage 2 and set at an administered price for day 1 of Stage 3 reflecting prices during Stage 2. If it is capped at £20/therm then this becomes a target for the market to have in mind and on occasions pricing behaviour will be influenced because there is a cap in place. Market players will constantly review their perceptions of where the market is in regard to the cap and this will influence behaviour such that the cap price itself is more likely to be reached than it would have been if no cap had been established.

Without the potential cap price influencing decision making both suppliers and customers would be free to make their own unencumbered decisions around risk and reward and would we believe allow DSR interruption to be established during Stage 2 at lower levels than they otherwise would be if the cap level had been established.

What is key during an emergency is that traded prices at the NBP are made 'available' by the Suppliers to the DM customers so that customers can make clean quick decisions on interruption safe in the knowledge of the exact level of compensation they will receive.

Question 3: Is one day domestic VoLL an appropriate administrative price for any firm load interruptions?

No for the reasons outlined above. We believe loads may be shed from the system at prices lower than domestic VoLL.

Question 4: Do you agree that it is appropriate to retain the Emergency Curtailment Quantity (ECQ) arrangements? If not please explain why.

Yes

Question 5: To what extent do our proposals alleviate shippers' concerns about credit implications of targeting the full cost of multiple days of interruption on shippers that were short on day one of a stage 3 (network isolation) interruption?

Although they alleviate the concern of massive credit exposures if there were to be full cost of multiple days of interruption on shippers the problem remains very significant at a cash-out rate of £20/therm.

Question 6: Should extended payment terms be applied to emergency cash-out (possibly to align with payments through the PEC payment process)?

In our view, during the uncertainty of an emergency, payment terms should not be extended. If a company is in financial difficulty it would be better for this to be exposed to the market as quickly as possible so that the remainder of the market can take appropriate correcting actions without delay, rather than allow the financial exposures to continue to grow.

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

We believe they will, although under the proposed regime we remain sceptical as to whether the volume of interruption contracts entered into will be sufficient to provide any meaningful improvement in security of supply. The survey evidence presented suggests that customers would rather pay a little more for 'insurance' to ensure an emergency never happens in the first place rather than consider contracting for interruption.

Many customers will not want to be fully interrupted due to process/plant issues which would be prohibitively expensive to rectify post event and/or would not want to invest in back up energy sources.

Question 8: Do you agree with our broad proposal for collecting monies from shippers and passing this through to customers? If not do you have an alternative proposal?

Although we agree with the broad proposal for recovering and redistributing payments some important challenges need to be addressed in designing any final mechanism.

The proposal does not address the likelihood of a shortfall in the fund monies due from short shippers and how such an eventuality would be handled. In an emergency scenario there is a significant risk that failure of shippers would leave the industry facing a significant shortfall. Additionally no regime should require a supplier to pay monies to a consumer prior to it receiving a corresponding payment from the shipper/fund. Given the potential size and nature of the payments described, imbalances might be unsustainable for some I&C suppliers which in turn could result in a failure of the whole supply market.

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 believe a significant gap in the emergency arrangements would remain not only because of a lack of interruptible contracting.
It is important that the total risk for the UK is assessed, including the very significant socio political 'externalities' that the Redpoint analysis excluded from the cost benefit analysis, and in response that Government/DECC/Ofgem agree on an appropriate level of insurance to be put in place at least cost.
This issue is too important simply to be left to the market to resolve.

Domestic consumers and industry are clearly signalling (ref. para. 2.44 of the Draft Impact Assessment) by indicating a willingness to pay increased bills to guarantee that an interruption does not occur that they would like real insurance to be put in place. The question that needs to be answered therefore is: for the money the customers are prepared to spend what is the best possible insurance that can be established?

In our view that insurance must include increased physical storage in the UK market.

In a UK market increasingly connected to and reliant upon global LNG and European pipeline flows, gas storage is the only way to guarantee that gas will be physically available at the time of emergency and would significantly strengthen the UK's overall Security of Supply.

Question 2: Have we captured the full set of potential further interventions? If not what other further interventions should be considered?

We feel the set of potential further interventions considered is comprehensive.

CHAPTER 6: Assessment of options

Question 1: Do you believe we have captured all the appropriate options?

A further option would be to allow cash-out to rise to the full value of lost load (determined by the market day by day) during Stage 2. On entering stage 3 then cash-out at an administered price is paid only for the first day of stage 3 interruptions. This approach would incentivise Suppliers to consider the full range of actions necessary to secure supplies.

Question 2: Do you agree with our assessment of the costs and benefits of the various options?

Hugely significant costs for the UK have not been included in the analysis and they do need to be reflected in some way if the best solution for the country is to be reached.

Most tellingly the Redpoint analysis suggests that no new physical investments will be made to improve security of supply out to 2030, whilst the UK's import dependency is increasing from 55% today to a level of 82-87%* and expected ramp rates of deliverability will increase markedly to back-up wind intermittency. It would seem unwise for the UK Government to put its faith to such a degree in the global LNG market, which provides over 50% of UK supply by 2030, to deliver gas precisely when needed and at a reasonable price.

An illustrative parallel may be drawn from the current Euro crises where it has been demonstrated that, as a nation, once you become heavily indebted and reliant on the short term market for funding you lose significant control of your own economic destiny.

We support the conclusion that intervention measures are needed, but we are not convinced that the quantitative assessment is the appropriate measure to justify this position. We recognise the difficulty in predicting the probability of an emergency occurring, particularly as we don't have any meaningful historical reference – noting of course that the landscape is going to change significantly over the next decade in terms of reliance on imports, reduced supply flexibility, uncertainty regarding generation mix and stack etc. Although we appreciate the attempt to quantify the costs and benefits, they are subjective and necessarily based on assumptions. We would suggest that the UK takes a more objective qualitative view given the criticality of gas supplies and the views of customers who are clearly indicating that they want Government to act conservatively to ensure an emergency never occurs.

* National Grid 10-year Statement 2011

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

As already indicated we believe further interventions in terms of storage are essential. We would question the timing of the introduction of the cash-out mechanism and whether it is appropriate to introduce it now in isolation, ahead of any further associated interventions.

We strongly believe the best solution will be found through an holistic approach to the problem which delivers a solution for the medium to long term. We don't advocate implementing the capped cash-out mechanism and then looking at additional measures as an add on as this may deliver a total solution which is sub-optimal and potentially costly to the consumer.

It would be much more favourable to find a solution to the total problem at lowest cost and implement that. However we do recognise that the clock is ticking and that actions to secure real physical supply needs to occur soon, ahead of the UK becoming exposed to the full force of a globally tight LNG market, which some observers think might occur as early as 2015.

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?

Our preference would be for a storage intervention placing an obligation on suppliers, National Grid or another national body to physically store gas reflecting the following;

1) Guarantees physical gas availability in market at the precise time it is needed.
2) Aligned with customer demands for, and willingness to pay for, insurance to ensure that an emergency does not occur.
3) Volume and peak obligations on suppliers/National Grid/other linked to their customer portfolio or a national measure.
4) Suppliers/National Grid/other are commercially incentivised to fill their store at least cost.
5) More closely aligns the UK supply portfolio with its European competitors enabling it to respond to any emergency in a similar fashion and at least cost.

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?

Assuming the significant issues we raised earlier on the willingness of both Suppliers and Customers to establish contracts for interruption can be overcome, then introducing standard contracts for interruption will not increase the incentive to contract. Indeed introducing a standard contract may constrain the development of least cost commercial structures between willing counterparties. Rather than introduce standard contracts in our view it would be better to allow the market itself to develop a range of contract structures for interruption.

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.

If the cash out price is left to float freely during stage 2, as we have suggested, then many of the concerns around potential gaming within any voluntary Demand Side Response Auction disappear. Customers will bid in their appropriate VoLL if they wish to participate. Their alternative is to wait until an emergency and then make their judgment around the price of offering interruption at the time. What is key during an emergency is that traded prices at the NBP are made 'available' by the Suppliers to the DM customers so that they can make clear quick decisions on interruption safe in the knowledge of exactly what compensation they will receive.

However as we have indicated previously we don't believe this further intervention meets the scale of the challenge facing the UK and won't deliver a least cost solution.

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?

The challenge for the Government is to define the level of storage that is appropriate for the nation in the medium and longer term and then to establish the funding mechanism to ensure the investment occurs.

We expect to explore and evaluate alternative mechanisms for storage implementation during the Security of Supply dialogue recently established by Ofgem in response to the request by DECC.