International
ESBI Energy Innovation

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Dear Anna

Gas Security of Supply Significant Code Review – Draft Policy Decision

ESBI welcomes the opportunity to provide views and input to Ofgem's review and reform of the gas trading arrangements in order that they better facilitate the provision of secure gas supplies. It is proposed that this is achieved through the derivation of a more penal level of cash-out at times of supply curtailment and possible additional interventions that could mandate further security of supply measures. Gas security of supply is a key issue, particularly in a future generation mix that will include gas-fired generation as a key component for mitigating the impacts of increasing volumes of lower carbon, but more intermittent generation technologies. As an active shipper of gas in GB and the island of Ireland, the proposals could have a material impact on our business and the customers that we supply. We note that Ofgem's proposals only consider impacts for GB and do not look at impacts for shippers supplying generation and customers at the Moffat offtake. We would urge Ofgem to broaden its analysis to include these impacts.

This response provides a brief overview of ESBI and provides a high-level summary of our views on Ofgem's proposed policy decision and then responds to Ofgem's specific consultation questions.

ESB International

ESB International (ESBI) brings together our worldwide generation, engineering and related services businesses.

ESBI has been a developer and operator of independent Combined Cycle Gas Turbine (CCGT) generation projects in the GB market for almost 20 years. We own, operate and trade Corby power station and developed the 850MW plant at Marchwood, which was commissioned late in 2009. We are also at an advanced stage with our latest 860MW development at Carrington which is intended to become operational early in 2015. Additionally, we own and operate the 406MW Coolkeeragh plant in Northern Ireland. We are also developing further large-scale CCGT projects at other locations across GB. To service these developments, we are an active shipper of gas across the UK with capacity bookings at various places on the GB system including at the Moffat Interconnector. This provides gas for ESB's significant generation and supply interests on the island of Ireland.

In addition to increasing our conventional generation fleet, we continue to grow our position in the UK wind market. Our operational and development portfolio will be around 165MW, comprising: the 24MW West Durham Wind Farm in Northern England; the 20MW Hunters Hill; and 15MW Crockagarron projects in Northern Ireland. Additionally, we recently completed commissioning of what is England's largest on-shore wind farm, at 66MW, at Fullabrook in Devon and we have started construction of our 38MW Mynydd y Betws Wind Farm in South Wales. We are also active in the ocean energy sector.

Summary of views

To date, a liquid traded market has ensured that appropriate volumes of gas flow to, and within, GB and Ireland. ESBI recognises that the depletion of indigenous supplies of gas will mean that the future supply mix will be more diverse and increasingly subject to international factors. Ofgem's proposals, if implemented, could drive liquidity from the market and have wide-reaching unintended consequences that would be to the detriment of the market and actually halt supplies of gas to GB. If Ofgem believes the cash-out arrangements should reflect the costs that parties incur by not booking sufficient volumes of gas, we would suggest that a cap should not be placed at a theoretical VoLL and that true market actions should set cash-out prices. The NBP is the most liquid gas hub in Europe and maintaining this liquidity is critical to ensuring that competitively priced gas enters the market, when it is needed.

Ofgem's proposals would introduce an administered payment for interruption, set at a notional value for domestic VoLL of £20/therm. Notwithstanding our view that there should not be a cap on the value of cash-out, we do not believe the single £20/therm value adequately takes account of the wide range of customers across the domestic, industrial and generation sectors. We are particularly concerned that Ofgem appears not to have considered those shippers with bookings at the Moffat offtake point who supply domestic and industrial customers on the island of Ireland, and for whom the VoLL may be significantly different (possibly greater) than that determined by Ofgem. To this end, we would seek for Ofgem to include Irish shippers in its policy proposals and associated impact assessments.

We are strongly of the view that Ofgem should carefully consider the impacts that its proposals are likely to have on the credit requirements of industry participants, in particular smaller parties. It is probable that the proposals, if implemented as currently envisaged, would significantly increase the collateral requirements of those shipping gas within GB. At a time when credit and working capital is constrained in the financial markets it is likely that any significant increase in credit requirements would drive parties from the market, materially reducing competition. Ultimately, this would be to the detriment of consumers.

A significant proportion of DM customers are gas-fired generation stations. As the generation mix evolves and plant closures required under the Large Combustion Plant Directive (LCPD) and Industrial Emissions Directive (IED) are replaced by new, cleaner gas-fired plants, this proportion is likely to increase. Currently, there are a number of initiatives that will materially change the electricity markets. Firstly, Government has instigated fundamental reform through its Electricity Market Reform process, in order that its energy policy objectives are better met. This is creating particularly high-levels of uncertainty for industry participants at a time when significant investment must be made to meet UK targets for carbon reduction whist ensuring electricity security of supply. Within the European context, there are moves to better harmonise the trading arrangements across Europe in both gas and electricity which could lead to material changes to markets being mandated. Indeed, any changes that are introduced to individual country arrangements must be compliant with the European target model. Further, Ofgem has recently instigated an SCR on the electricity cash-out arrangements which layers further uncertainty on industry participants. We believe it would be prudent for Ofgem to delay implementing radical changes to the gas trading arrangements until greater clarity is obtained on more of these energy market uncertainties.

With regards the review of electricity cash-out, we are of the view that there may be value in looking at the electricity and gas cash-out arrangements in a more co-ordinated manner as both are linked and a more holistic solution that encompasses both may be achievable and preferable.

Finally, we are unsure as to why Ofgem has chosen not to implement those measures termed “further interventions” under its option 3 at the same time as any reform of cash-out. By deciding to introduce this piecemeal approach, Ofgem is unnecessarily introducing further uncertainty to the market, to the detriment of all that participate in it. If Ofgem wishes to introduce any of the further interventions specified in the consultation, we would seek for them to be introduced at the same time as any reform to the cash-out arrangements. As a minimum, we would require Ofgem to specify a definitive timeline for implementation of any further interventions.

Responses to specific questions

In this section we respond to some of the specific questions Ofgem raised in its consultation.

Chapter 3: Level of security

Q1: Are there any options for determining the level of gas supply security to be delivered by the market that we have not considered?

We are of the view that any gas supply security should be considered in relation to the standards set out in EU Regulation 994/2010. National Grid's current licence requirements appear consistent with this, by way of it requiring National Grid to develop and maintain a 1 in 20 standard system.

Q2: Do you agree with our approach to setting the level of security of supply?

The consultation does not specify a level of security of supply that Ofgem believes is appropriate: as such we are unable to provide comment. We would advocate a level of security of supply that is derived by the market, rather than administered by Ofgem. This system has worked to date and we do not believe that market will not continue to deliver adequate system security.

Chapter 4: Cash-out reform

Q1: Do you agree that it is appropriate to retain the Post Emergency Claims (PEC) arrangements? If not please explain why.

Yes, we agree that the PEC process should remain for shippers that are long. We would also look for greater certainty to be provided to shippers submitting claims under the process.

Q2: 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 on the demand side?

We are of the view that there should not be a cap on the value of cash-out and that it should be able to dynamically reach whatever level the market prices VoLL at. We do not believe the single £20/therm value adequately takes account of the wide range of customers across the domestic, industrial and generation sectors. We are particularly concerned that the analysis appears not to have considered shippers using the Moffat offtake and supplying domestic, generation and industrial customers in Ireland who may have very different characteristics and subsequently different levels of VoLL.

Q3: Is one day domestic VoLL an appropriate administrative price for any firm load interruptions?

No, applying VoLL in this way does not reflect the different characteristics of domestic, generation and industrial customers. Applying domestic VoLL in all instances is, in our view, likely to adversely impact the effective operation of the market.

Q4: Do you agree that it is appropriate to retain the Emergency Curtailment Quantity (ECQ) arrangements? If not please explain why.

If Ofgem is to progress its proposals then we agree that there is merit in retaining the ECQ arrangements. We also agree that there may be merit in looking at whether a similar arrangement could be introduced for NDM customers that are interrupted in an emergency.

Q5: 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?

The limitation to paying one day of VoLL in the event of network isolation goes some way to alleviating shippers' considerable concerns that the proposed changes will lead to materially more credit having to be provided, at a time when the financial markets are highly constrained.

Q6: Should extended payment terms be applied to emergency cash-out (possibly to align with payments through the PEC payment process)?

No, payment terms should not be extended as this could merely 'prolong the inevitable' in the event of shipper insolvency. Also, it would introduce further uncertainty for shippers waiting to be compensated under the new arrangements.

Q7: Will enhanced incentives to avoid an interruption occurring increase the number of interruptible contracts entered into by industrial consumers? Please explain why.

ESBI does not believe the proposed changes will lead to an increase in the number of commercial interruptible contracts between shippers and industrial customers. Indeed, the uncertainty that could be introduced around payment terms to shippers could reduce the already small number of contracts that currently operate. In addition, the £20/therm target VoLL payment could act as an incentive for customers to remain as contractually close to the new cash-out arrangements as possible and therefore act as a disincentive to signing bilateral agreements with shippers.

Q8: 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?

We agree that the most practical way to introduce modifications to cashflows would be to modify the existing UNC and licence provisions.

Chapter 5: Possible further interventions

Q1: 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?

It is difficult for us to provide a view on this question in light of a lack of a defined supply standard in Ofgem's consultation. If Ofgem believes there remains a gap, further interventions could bridge it.

Q2: Have we captured the full set of potential further interventions? If not what other further interventions should be considered?

The range of options in the consultation appears reasonable, albeit we do not believe mandating storage is appropriate and should not be taken forward as a possible option.

Chapter 6: Assessment of options

Q1: Do you believe we have captured all the appropriate options?

We would prefer for Ofgem to look at the further interventions as options for reform in themselves and not just as supplementary to reform of cash-out. We also believe there is merit in Ofgem looking at whether there should be consideration of differentiating rapid and slowly developing emergencies which does not appear to have been factored in to Ofgem's proposals. We are concerned that in the event of an emergency that develops rapidly, shippers could be left short and significantly exposed through no fault of their own.

Q2: Do you agree with our assessment of the costs and benefits of the various options?

We have no comment to make.

Q3: Do you agree with our assessment on a preferred option?

We have no additional comments to those already provided in this response.

Appendix 3: Further interventions

We do not have any additional comments on the possible further interventions, to those already made in this response.

Should you wish to discuss any of the views expressed in this response further, please do not hesitate to contact me.

Yours sincerely,

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