# Consultation on Gas Security of Supply Significant Code Review by Ofgem
## *Submission by International Power Plc*

## (I) About International Power Plc

International Power Plc (IPR) welcomes the opportunity to contribute to Ofgem's *Consultation on Gas Security of Supply Significant Code Review.*

International Power plc is a leading independent power generation company with active interests in closely linked businesses such as LNG terminals and water desalination. Following the combination with GDF SUEZ Energy Europe and International, International Power plc has strong positions in all of its major regional markets (Latin America, North America, the Middle East, Turkey and Africa, UK-Europe, Asia and Australia). In total, it has 66 GW gross capacity in operation and committed projects for a further 22 GW gross new capacity.

In the UK-Europe region, International Power plc has 13.2 GW capacity in operation and a further 1.3 GW under construction. This includes over 7.3 GW of plant in the UK market made up of a mixed portfolio of conventional plant – coal, gas, CHP, a small diesel plant, and the UK's foremost pumped-storage facility. Several of these assets are owned and operated in partnership with Mitsui & Co. Ltd. IPR's assets represent just under 9% of the UK's installed capacity, making IPR the country's largest independent power producer.

The company also has a significant gas and electricity supply business in the UK. GDF SUEZ Energy UK is firmly established as a specialist energy supplier to industry and commerce across the UK and has been operating in this market since 1999. We offer an innovative range of energy supply products to meet the requirements of all types of business, from small industrial and commercial companies, to energy-intensive industrial plants. We are constantly developing new products and adapting our services to meet the needs of business customers.

## (II) Summary key points

***General Comments***

- **IPR are not convinced there is a problem with security of supply in the GB gas market and we are opposed to the introduction of enhanced obligations on gas shippers.**
- **Recent experience shows that GB has exhibited high levels of private investment and has adapted to the challenge to secure diverse and reliable new sources of gas. As a result of this GB displays an impressive headroom capacity to deliver gas over and above its forecast peak day demand.**

- **IPR recognise some shortcomings in the current emergency arrangements for gas and we support the rationale to compensate connectees in the event of involuntary firm load shedding.**

- **It is important for Ofgem to introduce a pre-emergency demand side response scheme alongside in addition to any compensation measures. VoLL payments alone may detract from the incentive for commercial interruption which in itself could prevent the very occurrence of a Gas Deficit Emergency, therefore we encourage Ofgem to undertake further work in this area.**

## (III) Answers to 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?*

IPR consider that that effort for the GB market should focus on finding an appropriate solution to the commodity standard issue as opposed to one focussed on infrastructure. We agree that the level of gas supply security should be consistent with the EU Regulation.

Evidence suggests that GB has sufficient headroom to satisfy the infrastructure standard as defined in the EU Gas Security of Supply Regulation even in the event that its single largest gas infrastructure is interrupted. Total demand on a 1-in-20 peak day is currently forecast by National Grid to be ~550MCM/day and the total infrastructure capacity for GB is around 800MCM/day, which indicates notional headroom of ~50%. Even the loss of the Langeled pipeline supply (~70MCM/day) would not seriously damage the capacity headroom, reducing it to around 32%.

Over recent years the market has delivered diversity, and is continuing to deliver an abundance of capacity across a range of sources, these include new onshore gas storage, LNG re-gasification terminals and increased interconnector links with adjacent markets. This infrastructure development has increased the flexibility to deliver gas to GB customers and these investments have been made by market participants without significant regulatory intervention.

If we accept the fact that GB has abundant capacity, and hence will pass the infrastructure standard comfortably, the focus therefore for GB should be on the ability to utilise the abundant capacity available to it on peak days or longer spells of high gas demand. This ability to ensure the demands of certain end consumers is defined in the commodity standard of the EU Gas Security of Supply Regulation. Specifically the levels of protection relate to the demand levels of certain groups of customers only, namely domestic, small businesses and essential social services (such as those which may already be protected under the existing priority user “Category A” status in GB).

As a general principal we feel it is appropriate that any incentives for security are properly targeted at those companies who supply the "protected customers" as defined in the Regulation. Companies who can demonstrate flexibility in relation to demand reduction as part of their portfolio should be held harmless from any regulatory change.

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

See our answer to Q1 above.

**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.*

We see no reason to change the Post Emergency Claims Process as a result of the SCR changes being imposed.

**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?*

IPR agree with the concept of introducing a Value for Lost Load (VoLL) and hence a level of compensation for loads which are subject to involuntary interruption in the event of a Gas Deficit Emergency (GDE). This form of compensation does not currently exist in the gas arrangements and we agree that this is a deficiency that needs to be addressed. The approach (or stages of an emergency) adopted by the National Emergency Co-ordinator (NEC) dictates that large loads are targeted first and that these options should be exhausted before taking action to interrupt, and to prevent the need to interrupt, "protected customers" on the LDZ networks.

As a consequence, it is gas fired electricity generation (CCGTs) and other vary large NTS connected loads which provide the first response in the event of a gas deficit emergency. Following this large Daily Metered loads on the Distribution Networks are prioritised for interruption and by definition such loads are protecting smaller NDM and Domestic customers. Using this rationale, the opportunity cost of protecting smaller loads is the Domestic VoLL and hence it is appropriate to compensate larger loads at this level.

It is not clear from the London Economics modelling that the assumptions used to calculate non-domestic VoLL are entirely reflective of actual costs or relevant opportunity costs. For example, VoLL is highly variable in the case of large loads and it may be possible for these to exhibit a higher VoLL if factors such as consequential loss are included and this has not been fully explored in the analysis. For example, the market related effects of a power station buying back power and selling carbon allowances has not been subject to a range of price scenarios in the analysis.

Similarly, many non-domestic loads will have de-commissioned back-up fuel capability as a result of the switch to universal firm arrangements on both the NTS and DN networks - the cost of loss of gas supply to operations now will far exceed the costs exhibited previously.

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

Economic rationale would suggest that the opportunity cost is set at domestic VoLL however the actual VoLL for larger loads could be in excess of this in certain circumstances as outlined above.

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

The issue of the ECQ process needs to be considered further in light of Ofgem's proposals such that there are no conflicts between a shipper's ECQ and any emergency compensation payment.

**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?*

See answer to Q6 below.

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

We are not in favour of extended credit terms for short shippers in respect of emergency cash-out payments. Out of the two models we prefer Ofgem's option 1 – "Near Time" option where the cost of imbalance (including VoLL) is reconciled at Month + 23 days. The alternative "Post event" option, where balancing costs are reconciled 3-4 months after the event introduces additional risks for shippers who were in-balance or long during the event. Extending the payment timescales for short shippers could increase the overall liability for the rest of the shipping community as additional costs may accrue in the intervening period which may lead to further socialised charges in the event of insolvency or non-payment.

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

No, the introduction of the enhanced incentives such as the VoLL payment, in isolation will deter commercial interruption ahead of a Gas Deficit Emergency (GDE). Further measures are necessary to incentivise customers to take-up demand side options ahead of time and to help prevent the onset of a GDE. In our view a DSR scheme is best achieved as a central buyer process whereby National Grid enter into DSR contract tenders or auctions with shippers for large loads and possibly aggregated smaller loads.

A central buyer model would be most effective for the following reasons;

- Large customers are unwilling to contract for long durations (more than one year) with gas shippers.
- A low probability/high impact event is best valued over a long period to achieve a realistic option price.
- A single buyer would better optimise the required volumes and should achieve a more efficient cost and;
- any perceived obstacles should be relatively easy to resolve as much of the groundwork has been established during the Network Interruption contracts established under UNC Modification 090.

We encourage Ofgem to undertake further work in this area to develop a DSR scheme.

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

It is important that the following processes are adopted;

- The funds collected from short shippers in relation to VoLL payments to customers should be set aside from usual energy balancing flows to ensure transparency and;

- there should be no obligation on shippers to pass through payments to customers until DSR payments have been received by the shipper i.e. shippers should not be exposed to any funding shortfall simply by virtue of their portfolio.

**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 are not in favour of additional obligations on gas shippers. Ofgem should focus on efforts to improve the pre-emergency incentives through the introduction of a central DSR scheme as previously discussed.

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

See above.

**CHAPTER 6: Assessment of options**

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

Ofgem should focus on efforts to improve the pre-emergency incentives through the introduction of a central DSR scheme as previously discussed.

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

No comment.

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

No comment

**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 are not convinced of the need for any further obligations. A prescriptive regulatory intervention is likely to distort the market and could deter future investments.

***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?*

Pre-emergency reform is best achieved by the introduction of a DSR scheme, as discussed previously.

***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.*

We would welcome progress in this area. GDF have previously given significant thought to this area, particularly in respect of our previous modification proposal UNC 086 – Introduction of Gas Demand Management Reserve Arrangements.

***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 are not convinced of the need for any further obligations such as a storage obligation. A prescriptive regulatory intervention is likely to distort the market and could deter future investments.

<u>End of response to questions.</u>

For further information please contact:

Phil Broom
Policy and Regulation Advisor
International Power Plc
Senator House
85 Queen Victoria Street
London, EC4V 4DP
Telephone: 0113 306 2104 or 0207 320 8728
Email address: phil.broom@iprplc-gdfsuez.com

*Or*

Dr Chris Anastasi
Head Government Affairs, Policy and Regulation
International Power Plc
Senator House
85 Victoria Street
London EC4V 4DP
Telephone: 0207 320 8995
Email address: chris.anastasi@iprplc-gdfsuez-ukeu.com