Minutes

# Gas Security of Supply Significant Code Review (Gas SCR) – Business rules workshop

| | |
|---|---|
| Date: | Friday, 22 June 2012 |
| Time: | 14:00 – 17:00 |
| Location: | 9 Millbank, London |

## 1. Opening presentation

1.1. Tom Farmer (TF) of Ofgem opened the meeting by providing a recap on the Gas SCR process to date. TF highlighted that Ofgem is considering stakeholder feedback, the interactions between the Gas SCR proposals and other work on security of supply and whether any changes should be made to the draft policy decision.

1.2. TF highlighted that the Authority plans to make its Proposed Final Decision on the Gas SCR in the summer. TF emphasised that the Authority had not yet made a decision to implement changes. If Authority decides in the summer to progress further the proposals to implement cash-out reform (and decides to pursue this using the Energy Act 2011 powers), then Ofgem would publish detailed business rules and proposed text for legal changes to the Uniform Network Code and licenses for consultation prior to making a final decision. To enable Ofgem to have the option of doing this, TF explained that Ofgem has worked with NGG to further develop the existing business rules that were first discussed with stakeholders in January 2012. The purpose of the workshop was to discuss and seek input on these updated business rules.

1.3. TF provided a brief update on the related Gas Security of Supply Report which Ofgem intends to submit to DECC in autumn 2012. Ofgem have been considering risks to GB Security of Supply and assessing potential further measures that might mitigate these risks. These two work strands have been carried out alongside the work on the Gas SCR.

1.4. One participant asked whether interactions with the electricity market had been considered further. TF commented that they had, particularly in the context of the Gas Security of Supply Report.

1.5. One participant questioned whether a decision in the summer would enable implementation in time for winter 2012/13. TF explained that implementation timescales would depend on the nature of the Authority's Proposed Final Decision and whether or not the Authority decided to use the Energy Act 2011 powers.

1.6. Participants commented on the expected process going forward, and were keen to be given opportunities to propose alternatives to the current business rules. Ofgem explained that these workshops are intended to be one such opportunity to do so, and that there would be other opportunities in the future. Ofgem stressed that the business rules are a draft based on Authority's draft policy decision, and are open to comments and alternative proposals on how the reforms could be implemented. Participants expressed preference that the process should follow the UNC industry modification route rather than using the Energy Act 2011 powers.

1.7. Participants questioned why the SCR was being discussed today without also discussing potential further measures. Participants were keen that the SCR and further measures were considered in the round. Further, some participants argued that Ofgem should organise a seminar outlining stakeholder responses to the draft policy decision. Ofgem clarified that the purpose of today's meeting was to discuss the current version of the business rules as one possible method of implementing cash-out reform under the SCR, and that it was important to think about how cash-out reform could be implemented to inform the Authority's decision on whether or not to progress further the proposals.

## 2. Business rules discussion

2.1. NGG outlined the key areas of development in the latest draft of the Business Rules. NGG began by recapping the purpose of the business rules and providing an overview of the existing and proposed Gas Deficit Emergency (GDE) cash-out process. NGG recapped on issues discussed at previous workshops, and proceeded to outline how the latest draft of the Business Rules sought to address these.

*GDE dynamic cash-out*

2.2. NGG outlined proposals that would make cash-out more dynamic during a GDE. Under current arrangements cash-out is frozen at the level that applies on day 1 of stage 2 of a GDE. The current proposals in the business rules would allow cash-out to be set on a day to day basis. For short shippers, this would be set at the System Marginal Buy Price for the relevant day, until firm load shedding occurs. At this point it would be set at VoLL for the rest of the emergency. For long shippers, cash-out would be set at the System Average Price (SAP) of the relevant day for the duration of emergency. These prices would be capped at VoLL as of the second day of a stage 2 GDE.

2.3. Participants expressed concern that in an emergency liquidity would dry-up and so there would be few (if any) trades to set SAP. Potential alternative options were discussed (including setting long cash-out at VoLL or leaving it frozen as under current arrangements) although participants didn't think any suggestions were ideal. Participants considered that the incorporation of VoLL was the key issue, as it could act as a target price for the market.

*Neutrality cash-flows*

2.4. NGG explained how emergency cash-out charges would flow through the neutrality process. Funds for involuntary DSR payments would be treated as a payment out of neutrality (the same as payments to long shippers). However, to reduce the credit exposure of the neutrality account, the DSR fund would be held within neutrality until invoices are settled and there are sufficient funds to pay consumers.

2.5. Participants questioned how queries, disputes and reconciliation would be dealt with, as neutrality rules operate on a "pay first, query later" basis. It was noted that this was a potential issue under the current arrangements, but that it could be more of a problem for shippers with a cash-out price at VoLL.

*Shortfall of funds for DSR payments*

2.6. NGG highlighted that there were two potential reasons why there could be a shortfall in funds. The first was if the total amount required for DSR payments was greater than the net surplus in neutrality once long and short cash-out charges were paid. The second was if there was a non payment of an Energy Balancing Invoice (EBI).

2.7. For the first instance, NGG outlined proposals whereby the shortfall would be targeted initially at short shippers. The proportion of the shortfall each short shipper would be liable for would be dependent on the ratio between the shipper's imbalance position and the total volume of DSR payments necessary. As such, short shippers will only pay for the proportion of the shortfall which can be directly attributed to them. If a shortfall remains following this charging, it would be recovered by neutrality. Some participants thought that socialising costs would undermine incentives, as even long shippers could be liable for some of the costs of emergency, and a shipper increasing throughput could increase the proportion of shortfall they have to bear. NGG noted that the thinking behind the proposal was that end of day imbalance positions might not necessarily reflect the within-day situation which led to the need to interrupt firm customers. As a result, the aim of the proposal was to target the appropriate proportion of a shortfall at short shippers, whilst recovering from neutrality the proportion of the shortfall that cannot be reliably targeted. Some participants agreed with this argument, but others thought that short shippers should pay the full cost of any shortfall.

2.8. The second potential cause of a shortfall – non-payment of an EBI – was outlined by NGG. The Gas SCR does not propose to change the arrangements for recovery of non-payments (and so these will be recovered by neutrality in subsequent EBIs). It was noted that this could cause a significant deficit in neutrality if DSR payments were made immediately. The current proposal to mitigate this is to hold DSR funds in the neutrality account and only make DSR payments once sufficient funds are in the neutrality account. This would avoid neutrality having to obtain a substantial credit facility in order to manage this deficit.

*Payment timescales*

2.9. Some participants were concerned that this delay in payments to consumers would have an adverse financial impact on consumers who had suffered significant loss due to a GDE. Participants did not think consumers would be able to obtain credit to manage this cash-flow issue, and so could be at risk of insolvency. Participants raised questions about how the timing of payments to consumers would interact with the possible penalties that could be introduced in the electricity capacity mechanism under Electricity Market Reform (EMR). It was noted the detailed design on the EMR capacity mechanism is unclear at this time. One participant asked whether payment in stages could be an alternative option, with an initial DSR payment made earlier based on available funds, and the remainder paid once the rest of the necessary funds had been recovered.

*Impact of NDM curtailment on shipper imbalance position*

2.10. NGG outlined a current issue with the emergency arrangements, whereby shippers could become longer (or less short) as a result of emergency NDM curtailment. The current SCR business rules contain provision for a process to uplift shipper imbalances such that they do not benefit from NDM interruption. This process is analogous to the existing ECQ process for DM demand. NGG explained how this process would work, with the uplift based on the difference between forecast demand and end of day actual allocated demand.

2.11. This process would be run on any day in which NDM demand is curtailed. One participant noted interactions with potential changes to allocations under Project Nexus.

*Derivation of DSR NDM curtailment volume at network isolation*

2.12. NGG outlined that it will be necessary to estimate what volume an NDM site would have consumed in order to calculate the level of DSR payment which they are due. NGG explained that the current business rules proposals would base this calculation on each individual site's SOQ. This would be scaled according to the ratio of total NDM curtailment to the sum of all curtailed sites' SOQs. Participants questioned whether this would lead to sites with more variable loads benefiting over sites with a flatter load profile. This was acknowledged by NGG, but it was noted that any estimate of this type would necessarily contain some inaccuracies. Participants suggested that these volumes could be calculated by load bands to reduce this impact.

*Other issues*

2.13. NGG highlighted that, under the current draft of the business rules, commercial demand reduction (or interruptible) contracts would be excluded from the ECQ process, regardless of whether the customer is curtailed by the shipper/supplier or by the transporter. Commercially interruptible customers who are interrupted by the transporter would not receive DSR payments at VoLL for any volume agreed as interruptible under the contract, but suppliers would be required to pay the customer as under the terms of the commercial contract.  One participant commented that they thought that all consumers should receive payment at VoLL if curtailed by the transporter, regardless of whether they have a commercially firm or interruptible contract.

2.14. One participant commented that it was important for further consideration to be given to the interactions between a local network constraint and a GDE.  One participant said it would be instructive to model the financial impact of a GDE on shippers under the Gas SCR proposals.

2.15. One participant mentioned a Demand Side Response document referred to in an email alert from Ofgem. The document link in the alert was not working[1]. Ofgem noted that it is difficult to advise what this is without seeing the alert; however it is not something that is part of the Gas SCR.

## 3. Closing presentation

3.1. Ofgem closed the meeting, and agreed to look into the possibility of holding further workshops in the future.

[1] *Post-meeting note:* This document will be published shortly.  The focus of the document is limited to considering electricity demand side response.