

The background of the slide features a close-up, artistic photograph of interlocking mechanical gears. The gears are in various shades of blue and white, with some parts appearing blurred to create a sense of depth and motion. A large, semi-transparent white 'X' is overlaid on the left side of the slide, extending from the top left towards the bottom left.

Gas Security of Supply Significant Code Review Proposed Final Decision

Seminar

3 September 2012

Agenda

Time	Agenda Item	Speaker
10:00 – 10:15	Registration	
10:15 – 10:20	Welcome Remarks	Emma Kelso Associate Partner, Wholesale Markets
10:20 – 10:45	Outline of Proposed Final Decision	Andrew Wright Senior Partner, Markets
10:45 – 11:30	Discussion, Q&A	
11:30 – 11:40	Outline of process and next steps	Tom Corcut Senior Economist, Ofgem
11:40 – 12:00	Discussion of next steps	

Gas Security of Supply Significant Code Review

Outline of Proposed Final Decision

Andrew Wright
Senior Partner, Markets

Current emergency cash-out arrangements may no longer be fit for purpose

- To date, the market has delivered secure supplies for GB
- Increasing import dependency means GB may no longer be able to meet demand with indigenous production and “command and control” approach to an emergency
- Project Discovery:
 - Freezing cash-out in an emergency weakens incentives to bring gas into GB
 - Shippers do not face full cost of firm customer curtailments, and so do not have sufficient incentives to avoid these outcomes

The Gas SCR aims to...

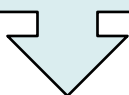
...minimise the likelihood of an emergency occurring by encouraging gas shippers and suppliers to undertake sufficient investment to enhance security of supply

...minimise the severity and duration of an emergency, if one ever occurred, by sharpening incentives to attract gas into GB

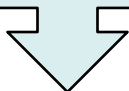
...ensure that firm consumers are paid for any involuntary DSR services that they provide in an emergency

Our SCR process to date

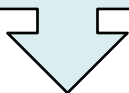
Initial Consultation published on
11 January 2011



Draft Policy Decision and Draft IA
published 8 November 2011



34 responses to the Draft Policy
Decision and IA



Stakeholder
events and
seminars held
throughout the
process

Responses to Draft Policy Decision

Some recognition that emergency arrangements should be reviewed

Comments about appropriate level of VoLL

Arguments in favour of providing FM relief from emergency cash-out arrangements

Concerns about impact on shippers and risk of financial distress

Concern about impact on market, including that VoLL could act as a target price

Arguments that market may not respond as assumed (eg, efficient market for interruptible contracts may not emerge)

View that cash-out reform should be considered alongside further measures

Our proposed final decision is to proceed with reforming emergency cash-out arrangements

- Cash-out unfrozen in a Gas Deficit Emergency (GDE); 'short' cash-out price goes to VoLL when firm customers are curtailed
- VoLL set at the estimate of the domestic level – £20/therm
- Imbalances adjusted such that shipper imbalances do not benefit from firm Non-Daily Metered (NDM) interruptions
- Payments to firm customers for involuntary DSR service
- Cash-out liabilities "capped" in the case of network isolation
- No introduction of Force Majeure exemption clause

Key policy decisions

- Key consideration is transfer of risk from consumers to shippers, as shippers better placed to manage these risks
- Do not propose to introduce Force Majeure exemption
 - Would weaken incentives on shippers to avoid emergency
 - Uncertainty over possibility of FM relief would harm response to emergency
- Single VoLL for all firm customers, maximises incentives for efficient demand-side discovery. We have not been presented with convincing evidence that such a market will not emerge
- “Capping” cash-out in network isolation balances interests of consumers in enhancing security of supply, with interests of shippers in not being exposed to inappropriate level of risk

Interactions with report for DECC and further measures

- Have considered both projects together, in line with terms of reference
 - ie, consider further measures which could be necessary *in addition* to cash-out reform (recognising that “capping” cash-out liabilities could leave a gap in the arrangements)
- Gas Security of Supply report considering:
 - Risks to GB security of supply
 - Further measures that could mitigate these risks
- We consider that further measures, if taken forward, would be a complement rather than a substitute for cash-out reform

Our impact assessment shows significant positive benefits from our proposed reforms

- Quantitative assessment shows positive net benefit, modelling shows significant reduction in energy unserved
 - Have revised modelling following stakeholder feedback on assumptions – overall risks are lower than outlined in draft IA
- Given limitations of modelling low-probability, high-impact events, we consider qualitative assessment and economic rationale are key
 - Provide strong incentives for shippers to take actions to enhance security of supply and reduce the likelihood of an emergency
 - Provide strong incentives to attract imports in an emergency

Considerations for implementation

- We do not expect to alter our high-level policy decisions unless material new information comes to light
- We have published for consultation proposed business rules and code and licence drafting
- We are open to industry-raised alternatives to implement our proposals
- We intend to use powers in section 36C Gas Act 1986 to direct changes to UNC, in order to provide certainty to the market ASAP on the nature of the reforms that will be made
- More on process later this morning

Questions?



Promoting choice and value
for all gas and electricity customers