

Gas Security of Supply Significant Code Review (Gas SCR) Proposed Final Decision – Workshop 2

Date: Friday, 21st September

Time: 14:00 – 17:00

Location: 9 Millbank, London

1. Ofgem – opening presentation

1.1. Tom Corcut (TC) of Ofgem opened the workshop. TC outlined the agenda and provided an overview of the issues discussed at the previous workshop. TC highlighted issues that Ofgem are currently considering, and emphasised that proposals in consultation responses to address these issues would also be welcomed.

2. National Grid Gas –storage curtailment and restoration

2.1. Claire Thorneywork (CT) of National Grid Gas (NGG) presented on two issues where clarification was requested at the last workshop.

Storage Curtailment

2.2. At the previous workshop, participants queried the arrangements for storage curtailment in an emergency, particularly whether they took account of the cash-out liabilities shippers could face if they are unable to access their gas-in-store due to storage curtailment. CT explained that the storage curtailment arrangements incorporate compensation which takes into account the prevailing cash-out price. This recognises that lack of access to storage could leave shippers faced with greater cash-out exposure than would have been the case if storage curtailment had not occurred.

Restoration

2.3. Stakeholders at the previous workshop had requested greater clarity on the process for exiting an emergency. CT gave a short presentation outlining the restoration process following a GDE. CT clarified that a GDE would end when the NEC considers that NTS and non-isolated LDZ linepack has been restored, and that supply either meets or exceeds demand. On the day the GDE ceases, NGG would recommence taking market balancing actions and so cash-out would resume being determined by the market.

2.4. CT noted that this could mean that a GDE could end whilst parts of the network remained isolated. These affected LDZs would be placed in a Local Gas Supply Emergency. CT explained that the UNC requires the market to be notified by 10:00 on the day before the GDE will cease.

2.5. One participant queried the influence that government could have over the process and where this power came from. It was noted that the Secretary of State may have powers under the HSE and government information in particular was of high importance.

2.6. Another participant asked, given the requirement for advanced notice before an emergency could end, what the minimum duration of an emergency would be, and whether shippers would be exposed to cash-out at £20/therm even once the issue which caused the emergency had been resolved. Ofgem noted that this is the same as current arrangements, in that short shippers would continue to be exposed to the frozen cash-out price until the end of the GDE.

2.7. A stakeholder suggested that consideration should be given to ways to speed up the restoration process to avoid short shippers being exposed to cash-out at VoLL for longer than necessary. Another participant suggested this should be considered by E3C (the Energy Emergencies Executive Committee).

3. Gas Forum – alternative proposals

3.1. Nick Wye (NW), representing the Gas Forum, gave a presentation on some alternative proposals that the Gas Forum had developed. NW explained that the Gas Forum is unconvinced by the proposed final decision as published by Ofgem. NW discussed possible alternative approaches that the Gas Forum consider would better achieve the SCR objectives, particularly focussed on reducing the risk of an emergency occurring.

3.2. NW outlined concerns that Demand-Side Response (DSR) would not emerge if it was left to the shippers and consumers to contract bilaterally for these services. Common to both alternative proposals is the introduction of a DSR tender. NW explained that this would be centrally co-ordinated by NGG, and aimed to procure sufficient DSR to provide insurance against an emergency. The costs of procuring these DSR services would be met by the whole of the industry, with the costs of exercising these contracts targeted at short shippers. These DSR services would be utilised ahead of an emergency.

3.3. NW explained that these alternative arrangements would provide customers with payments if they are interrupted in, or just ahead of, an emergency. Eligible customers who are successful in the DSR tender would receive an annual option fee in addition to an exercise price if they are interrupted. Customers who participate but are unsuccessful would receive some form of payment in the event that they are curtailed. Customers who are eligible to provide DSR services, but do not participate, would not receive any payments in an emergency. Ineligible customers (ie, small and domestic consumers) would receive payments at an administered level.

3.4. NW presented two alternatives for the determination of the cash-out price which could sit alongside the DSR tender. The first proposal involves keeping the market open so that the SO's actions could set cash-out prices. The cost of exercising DSR contracts would feed into the cash-out price. The second proposal would be based on current arrangements (ie, a frozen cash-out price), though DSR actions would continue to contribute to the cash-out price. NW suggested that an administered price set by an advisory panel based on the market situation could be introduced if necessary (for instance, to attract imports). NW set out the advantages of the two options for determining the cash-out price.

Q&A

3.5. One participant noted that the European Network Code on gas balancing, currently in development, may preclude Transmission System Operators (TSOs) from contracting for balancing services for more than one year's duration. However, another participant noted that the balancing network code would not apply to emergency situations, and so arguably the Gas Forum proposals would be excluded from this specific European Network Code provision.

3.6. One stakeholder raised concerns that the Gas Forum's proposals would effectively compel eligible consumers to participate in the DSR tender, and did not think this was appropriate. Another participant argued that this was beneficial as it provided strong incentives for the demand-side to participate.

3.7. Ofgem asked participants for their views on why they considered it better to procure DSR on a centralised basis rather than allowing the market to respond through shipper-customer contracting. One stakeholder was of the view that previous experience indicated that interruptible contracts were unlikely to emerge, even with the impact of the incentives created by the SCR reforms. They highlighted trust between consumers and supplies as a key issue.

3.8. Another stakeholder argued that the introduction of VoLL creates distortions in the market, providing a target price both for consumers in their negotiations with shippers and for traders in the approach to an emergency. Ofgem argued that they did not consider that VoLL would act as a target price, and questioned why rational shippers would not sell gas at the likely high prices in the approach to an emergency and instead wait for the possibility that the cash-out price could go to VoLL.

3.9. A participant noted that there was no guarantee that the incentives proposed by Ofgem under the SCR would lead to a physical response from shippers, highlighting that shippers may choose financial insurance as the best measure to mitigate risks. The participant noted that this course of action would not deliver security of supply benefits.

3.10. Another participant noted that they consider that there are significant barriers to customers signing commercially interruptible contracts with shippers/suppliers. The participant proposed that a survey could be carried out to provide evidence of the reasons for this. A further participant explained their view that a DSR tender would broaden the market and create competition between customers to provide these services, allowing them to be procured at a lower cost than they would be through bilateral contracting. One stakeholder noted that the cost of a DSR tender would provide a signal for alternative security of supply measures if these were cheaper.

3.11. One stakeholder queried whether, under Gas Forum's proposals, shippers would benefit from having additional gas to sell into the market once their customers are interrupted. It was noted that one approach would be that the shipper would be required to place the gas onto the market, at the end consumer agreed exercise price. The exercise price would then be reflected in the cash-out price. In effect the shipper would be required to continue to deliver the gas; recover the money through the market and settle the exercise payment with the End Consumer. Under this approach shippers would be unlikely to benefit from customer interruption through the proposed DSR Tender.

3.12. Ofgem noted that the Gas Forum's proposals should be considered, and that they could be seen as complementary to the reforms as outlined in the proposed final decision. Ofgem emphasised the need for significant new evidence if changes to the proposed final decision were to be considered.

3.13. A participant considered that the use of an administered VoLL set at £20/therm was not a viable complement to the Gas Forum's proposals. Another stakeholder considered that VoLL would have significant negative impacts on the market. A further participant agreed, and expressed the view that it would not be appropriate to make the reforms as outlined in the proposed final decision and then 'bolt-on' a DSR tender. Other stakeholders considered that the Gas Forum's proposals allowed payments to reflect the true VoLL of I&C consumers, and that the Gas Forum's proposals would provide industry-wide insurance and so not act as a potential barrier to entry.

3.14. Some participants asked what the appropriate process for further developing this proposal would be. One participant asked whether it would be helpful if the proposal were raised as a UNC modification. Ofgem did not offer a view, but agreed to consider this and provide a view at the next workshop. A participant again expressed the opinion that Ofgem shouldn't use its Energy Act 2011 powers, and should instead follow the usual UNC modification process. Ofgem responded that any alternative proposals would be considered and as appropriate presented to Authority, but reiterated that it was important that the proposal was backed up with evidence.

3.15. Ofgem thanked attendees for their contributions to the workshop and noted that the next workshop would aim to discuss the legal drafting published alongside the proposed final decision.