Alternative SCR Gas Security of Supply Proposals

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Gas Forum – Alternative Proposals to the Ofgem SCR

- Gas Forum remains unconvinced by the Ofgem Proposed Final Decision
- A number of industry participants suggested alternative approaches in response to the consultation document (and in subsequent SCR meetings)
- Two proposals have been developed which, in our view, better achieve the SCR objectives
- Common to the proposals is the concept of centrally co-ordinated Demand-Side Response (DSR)
- Our Proposals set out different approaches to the determination of cash-out prices

Demand-Side Response

- Some untapped DSR volume available immediately (i.e. customers with back-up fuel and those who are prepared to go without gas on cost / operational grounds)
- Additional volumes potentially available in the longer term if customers invest in back-up fuel capability
- Voluntary DSR actions take place ahead of a GDE; ability to interrupt triggered by Gas Deficit Warning (or equivalent). Achieves primary goal of reducing the likelihood of a GDE
- Provides NGG with greater certainty about Shipper / customer response to system tightening – currently a weakness in tight system scenarios
- Restoring I&C interruption to historic levels would halve the risk of unserved energy demand*

Demand Side Response offers the easiest and quickest route to enhanced gas supply security

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* GB GAS SECURITY OF SUPPLY AND OPTIONS FOR IMPROVEMENT: A report to Department of Energy and Climate Change March 2010 by F

But necessary volumes of DSR will not be delivered if left to shippers and customers

- Significant efforts made by Shippers to increase Shipper interruptible volumes following the winter 2005-06 experience, but with very limited success
- Suppliers / Shippers understand that customers are not interested, not sufficiently engaged, or are suspicious of "commercial" interruption
- Some customers have stated that they would be more comfortable responding to genuine System Operation difficulties (as established by NGG) than Shipper-called interruption, which may be commercial in nature.
- Operating Margins (OM) and DN transportation interruption processes provide a blueprint and establish excellent precedents for DSR facilitated by the system operator

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Key Principles of Centrally Co-ordinated DSR

- Must allow Option and Exercise elements; Exercise-only won't provide incentives for investment to establish / re-establish back-up facilities.

- Option premiums recovered through:
  i) An uplift on non-emergency SMPb (therefore targeted at short Shippers) and scheduling charges. This incentivises better routine balancing behaviour. Under-recovery is rolled into a commodity charge in Y+1; or
  ii) Transportation charges – socialised across all Users (recognises shared responsibility for security and that shippers' portfolios will vary year-on-year, which undermines likelihood of medium to long-term shipper DSR contracting).

- Preference for NGG to contract directly with customers. We believe acceptable "legal separation" (e.g. Transporters not allowed to contract with customers) workarounds can be found, as in electricity market. Alternative – Shippers provide the conduit.

- NGG assess requirement for interruption Y+1. Provides a forecast for Y+2, 3, 4 and 5, possibly using TYS data. Able to contract for multiple years where there is a consecutive interruption requirement; facilitates end user investment in back-up facilities.

- NGG conduct an auction / tender (akin to Operating Margins) to acquire volumes (NGG to publish required volumes in advance?).

- DSR actions rank alongside 'buy' actions in NGG's system operation tool box in price order, but DSR only available once a GDW (or equivalent) has been declared.

- No compensation to individual customers where they were able to take part in the DSR market, but chose not to.

- Restricted compensation payable to customers who take part in the DSR market test, but whose offers are not accepted.

- All customers who are ineligible for DSR (i.e. Small NDM, domestic) compensated, e.g. In-line with Ofgem's proposal.

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Example - DSR

Customer	Daily volume	Option fee	Exercise price	Comment
Joe Bloggs inc	50,000th/d	£100,000	£2.40/th	Back up fuel source available
Sili-clear	250,000th/d BUT must retain 50,000th	£1m	£4.50/th	Glass co partial interruption as needs minimum feed for furnace
Ferti-Liser	400,000th/d	£2.5m	£3.60/th	Option fee linked to economic cost
Neverundercut	50,000th/d	£125,000	SMPb	Takes floating price to ensure he gets best price

- An auction system similar to the Operating Margins tender, including (2)hr lead time.
- Partial interruption is an important feature as it provides the most effective exercise price for most consumers (e.g. Sili-clear might increase its price to £15/th, if it faced the risk of molten glass solidifying due to interruption).

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Treatment of Costs and Payment of Compensation under NGG-facilitated DSR Proposal

	DM and eligible NDM – DSR offer accepted	DM and eligible NDM – DSR offer not accepted	DM and eligible NDM – no DSR offer made	Ineligible for voluntary DSR
Ahead of Gas Deficit Warning	Any "Option" element paid in full. Recovered through (i) uplift to non-emergency SMPb and scheduling charges, or (ii) uplift to transportation charges	Record kept of customer's offer. Customer confirms that offer remains "live" for reference in a "customer DSR PEC" if a GDE is called	No change from prevailing arrangements	No change from prevailing arrangements
After GDW, but before GDE	Any "Exercise" element paid if customer's load called off. Targeted at the day's short shippers	No change from prevailing arrangements	No change from prevailing arrangements	No change from prevailing arrangements
During and after GDE	Priority given to restoration of supply (vs. "offer not accepted" and "no offer made" loads)	Load interrupted/ restored as instructed by NEC (restoration only after "offer accepted" loads)	Load interrupted/ restored as instructed by NEC (restoration only after "offer accepted" and "offer not accepted" loads)	No change from prevailing arrangements
Compensation entitlement	Limited to pre-agreed option and exercise payments	**EITHER**: Compensation payable at administered VoLL – 1st day only. **OR** unaccepted offers assessed post emergency if customer interrupted – similar to PEC process for long shippers	No compensation payable	Compensation paid at administered VoLL price and duration

Restricting compensation and reconnection order incentivises competitive bidding

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Cashout
Proposal 1 – Keeping the market open

- In all circumstances, the OCM is kept open to set cashout prices. Whilst trading activity may reduce during an emergency, the capability to transact is important.
- There is no VOLL and there is no cap to prices.
- There is no frozen SMPb or 30 day rolling SAP. Prices are set via the OCM, with previous day prices prevailing in the absence of trades on a day. Prices are dynamic so can adjust to prevailing demand / supply conditions.
- NGG are able to participate either by accepting offers for physical gas supplies or by placing locational bids for incremental sources on the OCM.
- DSR option exercise fees contribute to the determination of SMPb (effectively a physical trade executed by NGG).
- In order to limit potential for small volumes setting “extreme” system prices, minimum bid sizes or weighted average of a specified volume of marginal bids could be employed.
- Competition law / REMIT deters potential market manipulation
- PEC process is not necessary as offers can be accepted

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Cashout
Proposal 2 – Prevailing Arrangements plus

- Market remains open until Firm Load Shedding; all DSR options are exercised; or market liquidity dries up (liquidity measure?)
- DSR exercise fees feed into SMPb
- At market suspension, prevailing SMPb could apply or some form of administered price possibly set by advisory Panel akin to BSC

Advantages of the Cashout Proposals

Market Open	Prevailing +
Market based cashout	Recognises liquidity may be insufficient to provide robust prices
Prices will not rapidly escalate to a pre-determined cap	If panel involved it allows prices to be set which are reflective of the conditions, e.g. prices in competing continental markets
Prices can exceed Ofgem capped level if need to attract gas otherwise destined for Europe	Prices reflect actual price of DSR particularly if suspension occurs post-exhaustion of DSR offers
Reduced possibility of contagion	Reduced possibility of contagion
Prices reflect actual price of DSR	

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