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Gas Security of Supply Significant Code Review – Proposed Final Policy Decision Introduction

Corona Energy (CE) thanks Ofgem for the opportunity to respond to the Gas Security of Supply Significant Code Review – Proposed Final Policy Decision document. CE understands Ofgem's desire to improve the arrangements immediately prior to and during a gas deficit emergency. It understands the importance to the UK government of ensuring that the GB gas market and network is as robust as possible given the extremely changeable nature of the current energy markets. CE remains concerned however about the negative impacts the current proposals could have on the GB gas wholesale market in times of system stress and hopes that Ofgem will reconsider some aspects of its proposals.

Responses to the draft policy decision in January 2012 raised a number of concerns with the existing proposals and CE is yet to be convinced that these issues have been properly addressed. Of greatest concern is the consumer detriment that would be caused by the price inflation effect during times of system stress.

CE recognises the difference of opinion between Ofgem and the Gas Forum on this aspect. It is unaware of any trading or shipping organisation that has provided evidence supporting the Ofgem assertion that this proposal will not lead to an escalation of wholesale prices in times of system stress. CE also notes that all members of the Gas Forum Trading and Wholesale Markets Workgroup, whether shipper, supplier, trader (banks) or those running OTFs (exchanges and broker screens) were unequivocal in the view that significant wholesale price escalation would be a consequence of the proposal.

It is disappointing that Ofgem appears unwilling to consider the view that the markets are likely to accelerate prices more quickly during times of stress due to the expectation that prices may reach £20 per therm. This lack of adequate assessment of this fundamental aspect of the proposal leaves the analysis flawed and will leave suppliers and consumers paying higher prices than necessary during these periods.



Other Issues To Be Resolved

It is also notable that the proposals have not considered the impact on smaller independent suppliers like CE that are mainly reliant on the NBP to balance their portfolios. Few truly small independent suppliers have upstream production of their own or are owners of other flexibility assets such as storage (e.g. Corona Energy, First Utility, OVO, Ecotricity and even Gazprom are largely reliant on NBP trading to balance their portfolios).

Ofgem discussed the options available to shippers and suppliers to balance their portfolios and makes considerable unstated assumptions that these measures are all available to suppliers equally, on an economic basis and under fair and open terms.

It appears inevitable therefore that one consequence of the proposals as drafted will be that smaller suppliers will either have to accept greater levels of risk or be priced out of the market.

As smaller suppliers already suffer from a structural disadvantage (larger suppliers are far better placed to diversify their sources of gas due to their size and interests) this will merely exasperate this pre-existing situation and lead to a reduction in the competitive nature of the supply market.

Another important issue is the concern that some suppliers may choose not to take any action to address the possibility of a gas deficit emergency at all but instead take a short-term benefit through inaction. As such suppliers would not face any costs associated with the mitigation of the risk of the £20 VoLL, they would receive a commercial advantage by either growth of market share and/or increased profit. Given the strong commercial incentive, it would appear inevitable that this will occur at some point and when this does occur other suppliers can either lose market share or replicate the behaviour.

Additionally, the proposals introduce a risk that in the event of a significant gas deficit emergency occurring (despite mitigations being in place) the gas shipper market would be destroyed as a consequence of paying £20 per therm to every affected customer,. This would begin with all short shippers becoming bankrupt and would spread, through the energy balancing regime, to the remainder of the market.

Not only is this a real risk but it also will affect the behaviour of parties during an emergency. For example irrespective of available credit cover to trade, in periods of system stress, with the £20 VoLL risk in mind, parties will seek strategies that avoid trading with other shippers in order to limit their exposure. Short shippers may particularly find it difficult to find counterparties willing to trade as the perception will be that these parties face the greatest risk of default.

It is therefore much more likely that long parties would choose to remain long in the market (where National Grid is effectively the counterparty) than make trades with parties that risked failure.



Lastly, the proposal excludes NDM customers from offering a DSR service. It is not clear why this decision has been made and it appears to conflict with Ofgem and DECC policy to encourage DSR responses from all customers and the investments in Smart Metering and

Advanced Metering.

The only opposition to NDM customers offering this service appears to have been from a small number of individuals at xoserve who questioned where they would get the data from to calculate the effect of NDM sites (with smart or advanced metering).

Given this data will be available to all large NDM consumers by April 2014 under the Advanced Metering SLC, it would appear to represent a failure in knowledge and imagination not to allow these customers to offer DSR services if they wish. CE is therefore surprised that Ofgem is not demanding that suppliers, shippers and Gas Transporters mandate equal treatment for all such customers under these arrangements.

Are We Convinced by a £20 VoLL?

Corona Energy understands the logic behind compensation to consumers for a loss of service being linked to a Value of Lost Load (VoLL) calculation. What appears less clear is that the calculation of £20 per therm to be paid for a single day, irrespective of size of customer, nature of their business, time of year, type of contract, amount of off-take (consumers tell CE that removing tranches of demand is often significantly cheaper than a full shutdown) and other relevant factors, actually represents an accurate or reflective VoLL.

Since the original SCR proposals were launched by Ofgem the concept of VoLL appears to have altered considerably. As such the £20 per therm figure must be incorrect because, even if it were correct originally, the premise on which it was calculated has now changed.

It should also be noted that an I&C VoLL is likely to be different from a domestic VoLL but Ofgem is proposing a single VoLL which will impact on both markets. This could have two negative effects.

For some I&C customers the VoLL could be too low and would not reflect the impact on their businesses. For other I&C customers the VoLL will be too high. As such the VoLL would reduce their willingness to enter into DSR arrangements on commercial terms as it would raise an unrealistic expectation on the value of their DSR response. It is essential for this proposal to work effectively that the VoLL value is more accurately assessed and that it should more accurately reflect the circumstance of the consumers.

CE notes that consumers, shippers and suppliers have been working with the Gas Forum to create a central DSR proposal. This could provide data which could be used to calculate a VoLL for other I&C customers in a more accurate manner.



Lastly, it is not clear that VoLL is appropriate in all circumstances. For example, in a time of war the British Isles could be under siege in which case no amount of planning, effort or hindsight by a shipper could avoid gas supplies being curtailed.

Will Commercial DSR Fill the Void?

CE has discussed the use of interruptible services with many of its customers over many years. It has rarely discovered an enthusiasm from consumers to offer DSR services on a commercial basis. It has previously provided to Ofgem details of the problems faced by consumers that offer DSR services and hence the reasons for the consequential reluctance.

On the other hand CE is convinced that many of its customers may be willing, for reasons of Corporate Social Responsibility, to offer a DSR service in the event of a National Emergency. CE notes that it is currently co-operating with the MEUC, the Gas Forum and ICoSS to distribute a survey of I&C customers to understand more accurately the appetite customers currently have for DSR and their attitude to a centralised service.

If you would like further information or clarification of this letter please contact Richard Street on his mobile (07920 803271) and he will be happy to discuss this in more detail.

Many thanks,

Richard Street
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*please note that this letter will not be signed as it has been sent electronically