

Gas SCR Technical Working Group – Workshop 2

Industry working group to discuss Ofgem’s latest thinking on cash out reform and design options for a demand side response auction.	From Date and time of Meeting Location	David McCrone 11 March 2013 Ofgem, Millbank, London	14 March 2013
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1. Update by DECC on security of supply

- 1.1. DECC explained that their ongoing work follows Ofgem’s Gas Security of Supply Report to government. They agree that GB is a strong, well functioning market but expect there to be new risks in the future (LNG market tightening, increasing reliance on imported gas) that may expose consumers to price spikes. DECC supports Ofgem’s work on the Gas SCR.
- 1.2. DECC expects to make a decision on the need for further interventions by spring 2013 and if it decides an intervention is necessary will also indicate a preferred option.
- 1.3. The Demand Side Response (DSR) and information obligations in Ofgem’s report are not being pursued by DECC. Ofgem are leading on these with the DSR auction being considered as part of the Gas SCR.
- 1.4. DECC have also discounted the financial reliability option as complicated, and the distillate obligation on CCGTs as being counter intuitive to incentivising gas generation.
- 1.5. DECC are still considering non specific, storage specific, and semi-regulated storage obligations. A cost benefit analysis is being undertaken. They will update stakeholders at Ofgem’s next workshop in April 2013.

2. Cash-out reform presentation and discussions

Cash-Out

- 2.1. Tom Farmer introduced Ofgem’s latest thinking on cash out reform with the main focus being cash out for short shippers within a Gas Deficit Emergency (GDE).
- 2.2. At Stage 2 it was proposed that the cash-out price set would be set by the DSR clearing price except in circumstances where SAP was higher. One participant asked whether this could mean trade is moved on and off the OCM to influence the market.
- 2.3. Ofgem also confirmed that it’s minded to position was to set an administrative price in stage 3.
- 2.4. A participant asked if there could be a scenario where network isolation occurs but some DM consumers are still on supply. This could happen due to locational issues or in the event of network isolation where it would take a significant time to reconnect NDM sites, but there could be sufficient gas available for DM’s to consume.
- 2.5. Ofgem/National Grid will provide clarity by the next workshop on how a transportation constraint emergency and a gas deficit emergency interact, and whether one could influence the other (e.g. an abundance of gas in GB but concentrated in one or more LDZ).

Shortfalls and non-payment

- 2.6. Tom Farmer advised Ofgem's minded to position on shortfalls and non-payment was to limit payments to what can be recovered from short shippers noting that further work was required on the detail and particularly the practicalities of implementation before it could be confirmed that such a position was achievable.
- 2.7. Stakeholders generally welcomed Ofgem's minded to position and whilst acknowledging that the business rules needed development they were confident it could be delivered.
- 2.8. A question was asked over how the pot would be split up. If a bid was not accepted and the consumer later interrupted, there may be a risk that they be paid less and therefore reduce incentives to participate in the auction. Tom Corcut suggested that one option would be to apply pro-rating of payments to consumers interrupted in an emergency only and therefore auction bids exercised ahead of an emergency would be unaffected. This detail would need further consideration as the proposals were developed.
- 2.9. It was noted that there could be concerns if consumers were paid less than their expectations due to a shortfall. This was countered with a comment that restricting payment to what has been recovered helps to maintain competition.

Criteria and Fallback Price

- 2.10. Tom Farmer introduced some issues around setting criteria and a fall-back price for dynamic cash-out and asked for comments and suggestions from industry. Please could suggestions be sent by March 25th to GB.Markets@ofgem.gov.uk

VoLL

- 2.11. Anjali Mehta noted that a number of stakeholders had responded to consultations disagreeing with the way in which NDM VoLL at £20/therm had been calculated.
- 2.12. She provided an update on the calculation of VoLL noting that Ofgem would be recommending a VoLL of £14/therm to the Authority.
- 2.13. One participant noted that this still causes a credit issue.
- 2.14. One other participant asked why there needs to be a link between cash-out and VoLL. At the December roundtable discussions participants had agreed that NDM consumers can't have a market derived price so it must be administered. Ofgem also reiterated that cost reflective pricing was one of the core principles of the Gas SCR.
- 2.15. One participant felt the level of VoLL was an order of magnitude over than what the market would ever reach. There was a discussion on the electricity equivalent where DECC have used VoLL of £10,000/MWh which equates to approximately £60-70/therm. This figure was questioned as work on the electricity capacity mechanism was ongoing and whether NEC would ever let it get to that stage.
- 2.16. A participant suggested that if cash-out was £14/therm then the arrangements around how long £14/therm would prevail in a GDE and restoration of supply must be considered. Ofgem will respond to this request at the next workshop.
- 2.17. A participant asked whether stage 3 was inevitable once stage 2 was reached. There was a concern this would make it more likely that the market price would be driven up in extraordinary circumstances if participants thought they could hold back for a guaranteed price. Ofgem referred to the modelling undertaken as part of the impact assessment which demonstrated that it was definitely not the case that stage 3 would be reached in event of a GDE.

- 2.18. A participant asked if smart meters could be used to derive NDM VoLL. This was possible but agreed that it was some time off.

3. Discussion on Auction Design - Presentations by ESP Consulting And Centrica

- 3.1. Andrew Chattrabhuti presented ESP's proposals for a DSR auction. Chris Wright (Centrica) provided an update on UNC 435 and noted that they had reached similar conclusions to ESP and Ofgem.

Eligibility

- 3.2. Andrew discussed we are minded to exclude CCGT's and that for practical purposes, ie for physical response and being able to contact individual sites, a minimum volume threshold may need to be considered as there are currently 1200 DM sites.
- 3.3. A stakeholder disagreed that 1200 DM sites were too many to contact individually and asked if this could be delegated to the GDNs. He also noted that 35,000 AMR sites would exist from April 2014 and asked if these would be eligible. Another participant suggested that email could be used to contact high volumes of consumers.
- 3.4. A participant questioned the potential exclusion of CCGT given that all volume of gas was desirable regardless of source. He felt that excluding CCGTs risks limiting the power of the DSR auction to provide a meaningful response to avert a GDE.
- 3.5. Tom Corcut said that eligibility was still being discussed and no one was ruled in or out at this stage.

Auction design options

- 3.6. On Option 1, one participant said that 'pay as clear' did not provide the gradual step up in costs which could avert a GDE. ESP explained how a pay-as-clear this approach would drive costs down when compared to pay-as-bid.
- 3.7. Another participant said that as the OCM was paid-as-bid, it was not appropriate to use the DSR clearing price to set cash-out. This would need DSR to be paid-as-bid in order to work.
- 3.8. The group discussed that the DSR auction should work alongside the OCM and be an alternative depending on the cost.
- 3.9. Ofgem will consider the concerns raised about pay-as-clear versus pay-as-bid. Tom Corcut explained the key is to try and ensure there were incentives on auction participants to bid in at their true VoLLs and not try to guess the clearing level. One participant stated that in a perfectly competitive market, pay-as-bid versus pay-as-clear should provide the same outcome. It was noted that GDN interruptible contracts operate as pay-as-bid.
- 3.10. A participant noted that Option 1 doesn't incentivise participation from anyone who can't already provide DSR. Tom Corcut disagreed as it provides a payment if accepted as opposed to nothing as under current arrangements.
- 3.11. A participant said a con of Option 1 was that it is harder to penalise a consumer if they fail to act. In response, Ofgem representatives suggested that it could make it easier because you would not have to reclaim options fees. It was agreed that more work on penalties was required.

- 3.12. A participant noted it would be difficult to measure the level of response and whether this should be based on a predefined base load or day before consumption.
- 3.13. Ofgem noted that they would like to work with the UNC 435 working group to move forward and develop thinking on penalties.
- 3.14. Option 2 was discussed and the differences to Option 1 were noted. The 435 proposal favoured an option fee plus exercise price as it gave an incentive to invest and participate.
- 3.15. Tom Corcut explained that he favoured an exercise only tender – Option 1.
- 3.16. A participant asked if a budget for option fees has been set- the level has not been considered.
- 3.17. There was support for partial interruption being possible and to bid in tranches.
- 3.18. A participant reiterated that partial interruption and bidding in tranches was essential to get full participation.

Reserve price

- 3.19. There was general concern about using NDM VoLL as a reserve price for DM bids. Participants were concerned that the price would always reach £14/therm in a GDE.
- 3.20. One participant said that if a reserve price is known upfront, all bids will reflect it. Tom Corcut said there was no evidence to confirm or deny this would happen but there must be a point where manufacturers would stop producing as it was no longer profitable.
- 3.21. On the issue of NDM VoLL as guide price for bids, a participant said this could encourage NTS users to bid high as they would be guaranteed to come off first in firm load shedding anyway and the market influence of these consumers was being ignored.

Ofgem and ESP Consulting will consider the need for a reserve price and report back at the next workshop.

Next Steps

- 3.22. Tom Corcut welcomed the common ground between 435 and Ofgem’s proposals. There was general agreement that it would be helpful for the UNC435 workgroup and Ofgem to work on certain areas more closely to ensure an efficient process.
- 3.23. Ofgem will consider the actions noted above and update the working group at the next workshop on 8th April.

Action	Person – By
Provide clarification on the differences between a transportation constraint emergency and a gas deficit emergency, how they interact, and whether one could influence the other.	Ofgem, National Grid
Submit comments on the revised proposals to the GB Markets mailbox by 25 th March (GB.Markets@ofgem.gov.uk).	All
Confirm in the event of a GDE and network isolation how long the administered price would prevail	Ofgem