

Gas SCR Technical Working Group 3

A working group held to discuss Ofgem's SCR proposal with updates from DECC and industry. The meeting also set out Ofgem's next steps in implementing cash-out reform.

From
Date and time of
Meeting
Location

David McCrone
8 April 2013

Ofgem, 9 Millbank,
London

1. Introductions

1.1. Tom Corcut welcomed everyone to the working group and set out the agenda for the meeting.

1.2. In setting out the wider context it was confirmed that UNC modification 0435 will be amended within the next week. It was noted that NGG cannot start on developing business rules until this is done. Centrica will work with NGG to progress this.

2. Gas Security of Supply and Interventions

2.1. DECC presented their current view on gas security of supply and recognised opinion was split on the need for intervention and a decision had not been taken. They discussed the relative merits of three potential interventions being considered; a non-specific obligation, a storage obligation, and semi-regulated storage. DECC confirmed that these were further measures and complementary to other work being completed including the Gas SCR.

2.2. One participant asked DECC to confirm whether there is an issue with allocation or capacity. If allocation, then shipper and or system operator incentives may be appropriate. It was felt that this winter had shown the market had worked effectively and an obligation improving allocation of existing capacity was not required. If the obligation is aiming to increase capacity then they believed only semi-regulated storage would provide the revenue to encourage storage investment. In addition, to provide investor certainty, primary legislation is required.

2.3. Another participant asked DECC to note there were two gas storage markets: seasonal (driven by summer and winter spreads) and fast cycle (driven by short term volatility in gas prices). However, investment in one will affect the economics of the other; new seasonal storage may take revenue away from existing fast cycle storage which will in turn need greater price volatility to maintain revenue.

2.4. A participant asked DECC to be mindful of other interventions that may be harmful to security of supply. It was also noted that in the event of DECC choosing semi-regulated storage, the support should be provided to existing operators as well as new. There was a concern that this would otherwise crowd out existing operators and may exacerbate the problem it seeks to resolve.

2.5. One consumer representative welcomed DECC's efforts to increase availability of storage and reduce price volatility. They supported a storage obligation and semi-regulated storage. They were concerned about the price volatility in recent weeks and the impact of interruption on their members.

2.6. Another consumer representative had an alternative view and said the desire for storage would vary by consumer and dependent on the cost. Some consumers with fuel critical processes have back up fuel and so do not rely on storage. Therefore, any increase

in costs being passed onto consumers would be a concern. It was noted that their members would be less inclined to support a proposal to increase storage when they will have little or no control over the gas held in storage .

2.7. A third consumer representative noted that their members were worried about the cost of intervention and were moving away from support for new storage, considering alternative supplies, such as development of shale gas, as the answer to improved security.

2.8. In addition to security of supply, future flexibility requirements need to be considered. With the decrease in flexibility currently provided by CS and NCS gas, the role storage plays in the provision of future flexibility needs to be considered.

2.9. The final point raised by a number of participants was the consideration of unintended consequences of any intervention. Dependent on the intervention, there may be impacts on market liquidity and the impact on other sources of flexibility.

3. Gas Forum Presentation

3.1. Nick Wye presented on behalf of the Gas Forum but acknowledged that some positions in the presentation may have changed following Ofgem's publication of the TWG3 working paper. It was noted that the presentation said there was 50% agreement with Ofgem's proposals although this may now be higher.

Use of an administered price for NDM VoLL

3.2. There are still concerns with the use of an administered price even if it is only for one day.

3.3. The Gas Forum continues to maintain that there will be significant credit cover implications if an administered price of £14 per therm is used. Consumers who had contributed to the Gas Forum presentation were also concerned that this may act as a target price.

3.4. It was reiterated that industry wants a market derived VoLL.

Pay as bid versus pay as clear

3.5. The question of pay as bid versus pay as clear was discussed. The Gas Forum preferred pay as bid with reasons set out in the presentation. A number of participants strongly felt that pay as bid was a better approach.

3.6. Ofgem's rationale is that pay as clear provides the best incentive for participants' to reveal their true VoLL. It was noted that the compensation "pot" would be the same under both approaches but pay as clear returns more to consumers.

3.7. It was noted that Ofgem are not currently minded to favour one particular option and this would be consulted on.

Use of an auction reserve price or cap

3.8. Ofgem asked industry representatives if they were comfortable with no auction reserve price. This could mean unlimited cash-out. The example raised by a participant was with a high penalty for not producing in the Capacity Mechanism, eg £10,000/MWh, would imply CCGT's would be willing to pay up to £160/therm in the gas market. Therefore it was noted that markets with no cap have sought to introduce one soon after they have been established.

3.9. Nevertheless concern of having a reserve price in the auction was reiterated and there are concerns about it acting as a target price.

Possible liquidity criteria

3.10. The Gas Forum presented a number of options on liquidity criteria (eg number of trades/ participants, % of trades from previous day, etc). It was agreed that that these suggestions were broadly in line with Ofgem's proposals.

4. Ofgem's SCR Proposal

Ofgem's lead option for cash-out

4.1. Tom Farmer presented Ofgem's current lead option for cash-out reform.

4.2. A participant asked if the DSR exercise price would contribute to SMPbuy only, or if it would also feed into SAP. No final decision has been made but it is considered appropriate that DSR prices feed into both. However another participant did raise that there would be issues over the practicalities eg calculating volumes in real time to calculate the volume weighted price.

4.3. It was noted that payments to eligible but unsuccessful DSR participants were dependent on auction design. One stakeholder believed payment was guaranteed and this was a change of policy. Ofgem confirmed this was not necessarily the case and that for some auction designs that do not limit the volume of DSR procured (such as ESP's proposal) then it may be appropriate that bids exceeding a reserve price do not receive payment.

4.4. One participant asked if the slide titled "Payments to customers via cash-out" meant payments were capped. This is not necessarily the case. Via cash-out is taken to mean only that funds are recovered through cash-out, but this may also include balancing neutrality.

4.5. A participant asked if payments to DM consumers would be prioritised. It was suggested that it may be appropriate to prioritise payments for those that participated in the DSR auction to encourage participation.

4.6. As the proposals would mean that the cash-out price would not necessarily be set at an administered level, and could be valued at more than NDM VoLL in stage 3, stakeholders were asked whether this would mitigate concerns about the potential for NDM VoLL to act as a target price. One participant said this could possibly help but there would still be an escalation in prices compared to a counterfactual with no administered price in place.

4.7. A participant asked if Ofgem have powers to investigate possible market abuse in the DSR auction. It was agreed that any possibility for abuse should be addressed in the auction rules.

Robustness criteria and fall-back price

4.8. Stephen Jarvis presented on robustness criteria for SAP and a potential fall-back price. Feedback from participants was positive.

4.9. Some participants thought the minimum total volume seemed low but was not necessarily wrong. Ofgem were asked to get traders' views on an appropriate level.

4.10. A participant said that a minimum number of counterparties would be an appropriate additional measure. There was wider support for the inclusion on a number of counterparties.

4.11. On the fall-back price, several participants noted that the use of multiple sources in reaching an average was an appropriate method. One participant suggested a weighted average of the three prices could provide further assurance (rather than just a simple average).

5. Clarifications from Previous Working Group Meeting

5.1. National Grid circulated a paper ahead of the workshop clarifying the difference and interactions between a GDE and critical transportation constraint. This paper was not discussed at workgroup but if you have any questions please contact Claire - claire.l.thorneywork@nationalgrid.com

6. Process Going Forward

6.1. Subject to approval from the Authority Ofgem advised they will publish a letter in May/June 2013 that sets out the updated proposed final decision on cash-out reform. This will be accompanied by a consultation on high level auction design.

6.2. Following responses to this consultation Ofgem will publish the high level auction principles as well as business rules, draft code and licence conditions for cash-out in summer 2013. It is anticipated that National Grid will develop the detailed methodology for the auction.

6.3. Ofgem's aim is that cash-out reform and the DSR auction will be implemented as soon as possible and current thinking was that this would be for winter 2015/16. It was noted that Ofgem were reluctant to implement the measures mid way through a winter.

6.4. One participant was argued the timeline was excessive and questioned why it cannot be implemented earlier if possible. They noted that consumers are facing the risk to security of supply now.