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Minutes

Gas SCR Working Group minutes

Minutes from the Gas SCR working group on emerging thinking on DSR, a possible alternative solution and outstanding policy issues.	From	GB Markets
	Date and time of Meeting	14 October 2013
	Location	Ofgem, 9 Millbank, London

1. Introductions

1.1. Anjli Mehta (Ofgem) thanked attendees for their responses to the Gas SCR DSR consultation. It was confirmed that Pöyry Management Consulting has been hired to develop an impact assessment (IA) including a cost benefit analysis for cash-out and DSR proposals.

1.2. A participant asked if the IA would only cover what was discussed in the workshop or has a wider remit. It was confirmed that the IA will cover the DSR policies discussed at the workshop and the impact of cash-out reform

2. Demand Side Response

2.1. Stephen Jarvis (Ofgem) provided a recap of what had been included in Ofgem's DSR consultation, a high level summary of responses and the proposed options to be modelled. Ofgem have noted a number of the comments received to the DSR consultation and reflected this in the proposed modelling.

General views on the modelling options

2.2. One stakeholder asked why two modelling options contained no option fees. This was despite acknowledgement from Ofgem that the majority of consultation responses felt an option fee was essential for participation. It was clarified that it was important to consider the impact of option fees by modelling designs that included and excluded them.

2.3. A workshop participant asked what assumptions were being made on electricity Value of Lost Load (VoLL). This will include VoLL associated with electricity balancing and the Capacity Mechanism, starting at £3,000/MWh under cash-out and rising to £6,000/MWh.

2.4. There was some unease from an attendee about the assumptions that would be made given that they would be subjective. One attendee said that they did not believe the IA should be used in isolation to inform a decision. Ofgem confirmed that this would not be the case but one factor informing decision making. The participant supported an iterative modelling process being built into the timeline with the ability for industry to challenge the assumptions made. Ofgem confirmed this was not possible under the current timescales.

2.5. One stakeholder asked what base case was being used in the modelling. Ofgem confirmed that this would be current arrangements (ie no cash-out reform). The options being modelled against this are:

- cash-out reform and a DSR mechanism (various designs);
- cash-out reform with no DSR mechanism but some contingency arrangements

2.6. The justification for a single year only product was questioned. The aim is for the DSR tender to be as simple as possible in the first instance. This would be especially relevant if any trialling was required.

2.7. A stakeholder asked what reference volumes would be used to measure any response. NGG considered that it should be an agreement to turn volume down. Those representing the demand side opposed this saying it is easier to turn down to a specified volume (ie, not use more than a certain level of consumption). NGG raised concerns with this as they would not know what relief has been provided to the system by a given DSR provider. **Ofgem took an action to prepare a paper on this, receive feedback from consumers and discuss at the next working group**.

2.8. A participant asked if a consistent bid stack will be used across all modelling options. This was to allow a comparison of the impacts of each. The underlying VoLLs that are used will be consistent across all options and Pöyry's belief is that factors such as size of site, availability of back up and attitude to risk would influence bidding behaviour much more than tender design. Stakeholders will get sight of the VoLL bid stack used in the modelling.

2.9. Ofgem noted that there were various reasons given in response to the DSR consultation for not including a price cap.

2.10. One attendee felt the modelling should include a price cap to confirm or deny the fears expressed in the consultation responses. They claimed not all stakeholders had access to the robust modelling available to Ofgem and this would provide further confidence in the proposals. Ofgem will take this away and consider the merits of modelling a price cap.

2.11. Fixed option fees were discussed and Ofgem confirmed that the reason to exclude them was based on consultation responses, which expressed a general preference for variable rather than fixed option fees.

2.12. One participant asked how bids would be ranked if option fees were variable. No final decision has been made at this time. Ofgem noted that ESP Consulting's preference was to accept based on the option price, and exercise based on the exercise price. NGG expressed a preference for keeping any decision process simple.

Approach to formulating option fees and technical ability to participate

2.13. Tom Corcut then invited comments as to how consumers may choose to formulate option fees within their bid. This would be used to model variable option fees.

2.14. One attendee felt this was up to individual consumers and they may not want to express that publicly. Another suggested that consumer's chosen option fees may be influenced by the way in which bids would be judged.

2.15. A participant then clarified that past capacity tenders (Mod 90) showed a wide variety of option fees and that they were unable to speak for such a diverse range of consumers. The participant suggested that based on their own experience of the demand side, option fees would be based on the cost of back-up facilities. Such costs include capital costs (storage tanks etc.) as well as maintenance costs on top of this.

2.16. A further stakeholder said that option fees should be based on fixed costs incurred regardless of whether a GDE was called. Exercise fees would then be based on variable costs that were incurred only if the bid was exercised.

2.17. One participant questioned whether the inclusion of both option and exercise fees, combined with the intention for there to be tranche bidding, would create too much complexity. The participant asked whether a consumer could submit different option fees for different tranches, or whether only exercise fees could vary by tranche. It was noted by the group that it would likely be the case that both option and exercise fees would be able to vary for each tranche.

2.18. A consumer representative suggested that a trialling period with a low number of tranches may be appropriate in order to ensure this complexity was manageable and did not deter participation.

2.19. Participants were asked if they had a view on the proportion of potential I&C bidders in a DSR mechanism that might be excluded by a minimum response time of 4 to 6 hours.

2.20. A consumer representative stated that almost all I&C consumers would be able to participate if the response time was set at this level. They noted that CHP installations can actually respond much faster than this.

2.21. The representative for the ceramics industry pointed out that ceramics kilns take much longer than 4 to 6 hours to cool safely and that as much as 85% of a ceramics sites gas consumption would be for heating the kiln. As such this sector would likely be constrained by the minimum response time proposed.

How to fund option fees

2.22. The final question on the DSR tender was how participants envisaged any option fees could be funded.

2.23. One attendee expressed concern with the cost of option fees and if a budget had been set. They were worried about the level of costs incurred if no budget was set. It was confirmed that no budget had been agreed at this time. One participant asked what the annual cost of Operating Margins was as this may be indicative of the appropriate or likely costs of the tender. It was noted by the group that the cost of Operating Margins was in the region of £20-27m for approximately 100mcm, though much of this is procured from storage rather than the demand-side.

2.24. Another suggested two options for socialising options fees. These were either using a constraint management fund, or inclusion with the commodity charge. The latter did not have a budget but allowed Ofgem to challenge the figure if they wish. NGG suggested that depending on the design of the tender and the level of option fees bid and accepted, this could cause significant volatility for commodity charges.

NGG alternative to the DSR tender

2.25. Darren Lond (NGG) presented an alternative to the DSR tender proposed by Ofgem. The aim was not to drive competition or commercially interruptible contracts, but simply to reveal VoLL and inexpensive DSR. There was some support for NGG's alternative proposal as it seemed more suited to use as a contingency arrangement.

2.26. An attendee asked if the proposal excluded option fees, and was pay as clear. NGG confirmed that there may be potential for a very small fixed availability payment to be included and bids would be paid as bid.

2.27. Another asked if it would be a yearly product. NGG stated that the market would be open for updates until being frozen upon the declaration of a GDW. Bids would be a price for a volume to be interrupted until the GDE was called off. NGG stated that the alternative proposal has similarities with the OCM locational market.

2.28. There was some concern about the trigger point and if the proposal could set a high cash-out price prior to an emergency. It was argued by one participant that it would potentially foreclose the market and drive up the cost of other actions that would be available to NGG at the time. They felt that the proposal was potentially messy and confusing at the point a GDW is declared. They suggested moving the trigger point until later in the process. This would keep the market open as long as possible before any interventions by NGG. **Ofgem took an action to write a paper on the trigger point for discussion at the next working group.**

2.29. Participants expressed concerns that there may be little incentive to bid competitively, and potential for gaming. It was highlighted that this would form one of many tools available to NGG, and would be governed by the principles set out in the System Management Principles Statement (SMPS).

2.30. One participant asked if a consumer would be able to change the volume of their bid, or withdraw it, if their ability to provide DSR changed. NGG explained that current thinking was that bids could be withdrawn (but not altered) after they were frozen. NGG also highlighted that bids would be aligned with the minimum volume requirements of the OCM.

2.31. A participant expressed concern about shifting responsibility onto shippers. They thought the proposal was attractive but questioned whether shippers could realistically manage it. A representative from NGG pointed out that these contractual burdens were also present in the DSR tender. Another attendee felt this would require some change in the relationship between consumer and shipper – particularly if continuous updating of bids was required.

2.32. The interactions with electricity were discussed. NGG felt that CCGTs would be unlikely to participate as they had access to the OCM as well and there was general agreement with this view.

2.33. The working group were asked for final views on NGG's proposals. It was agreed that the proposal had merit and warranted further examination. The appeals of the proposal were that it appeared simpler than Ofgem's proposals and had comparisons with existing mechanisms. It was suggested that there might need to be a standard form of contract to encourage uptake and to avoid any disputes.

2.34. A consumer representative reiterated that whether the final DSR mechanism was a tender or the alternative proposed by National Grid, the key issue for consumers was whether the product was a 'turn down by' or a 'turn down to'.

3. Cash-out reform and outstanding policy issues

Contingency arrangements

3.1. Tom Farmer (Ofgem) presented on the shape of cash-out reform in the absence of any DSR mechanism. This is referred to as 'the contingency' and the presentation focused around the extent to which paying DM consumers SAP acts as a barrier to the negotiation of bilateral commercial interruptible contracts. He also presented on how NDM consumers would be paid in the event of a network isolation occurring.

3.2. Tom Corcut asked whether our concerns regarding incentives for commercial interruptibles are justified.

3.3. NGG clarified that the contingency payments to DM consumers would take place in Stage 2 as a result of firm-load shedding. This was due to the absence of any DSR mechanism for DM consumers to reveal their VoLLs.

3.4. A shipper representative noted that the situation was highly uncertain and so it is difficult to say what the impact would be. Another participant agreed that shippers would be less likely to negotiate interruptible contracts. They noted that DM consumers who are firm-load shed get nothing now and so any introduction of payments for interruption would make them less likely to negotiate with their shipper.

3.5. Tom Corcut and Anjli Mehta clarified that the key point was getting the balance right between ensuring DM consumers receive something in recognition of the fact that they have provided DSR to help balance the system, and ensuring that the level wasn't so high as to kill off any mutual benefits from commercial negotiation between consumers and shippers.

3.6. NGG raised a concern over how PEC may influence the payments received, and therefore the incentives to negotiate. Anjli Mehta acknowledged that the thinking presented thus far had not taken into account the additional impact of the Post Emergency Claims (PEC) process and that Ofgem would go away and do some additional work on this.

3.7. A shipper representative noted that short cash-out is uncapped and therefore potentially unlimited. This alone should be enough to incentivise a shipper to contract for DSR if that was indeed capable of reducing their exposure.

3.8. It was recognised that the group needed greater clarity on this issue before it can comment in an informed manner. **Ofgem took an action to provide participants with additional detail on this topic in a note and that discussion of this point can resume in light of that**.

Payments for Non Daily Metered (NDM) Consumers

3.9. The discussion then moved on to the payment structure for NDM consumers. Participants were told that Ofgem has a workable solution, but is open to any final suggestions of alternatives that are simple and maintain the same incentives as the current proposals. Participants can send these to gb.markets@ofgem.gov.uk by 23rd October.

Managing surplus/shortfall

3.10. Tom Farmer presented on the proposed treatment of any surplus or shortfall in the funds collected from cash-out charges and then used to pay long shippers and interrupted consumers.

3.11. Ofgem clarified that any shortfall following the netting of cash-out charges would first be recovered proportionally from short shippers, with any residual recovered from neutrality. Recovery from neutrality would be based on an alternative throughput (under normal arrangements neutrality charges would be based on throughput from the day in question). The use of an alternative throughput was intended to avoid disincentives to increase flows of gas during an emergency.

3.12. Tom Farmer outlined possible options for the alternative throughput. NGG stated that the use of an alternative throughput based on 365-day throughput is likely their preference.There was support from some participants for a 365 day spread. It was considered that this might avoid any near time skew and lessen the impact of a smear to neutrality.

3.13. One participant asked where the rules for these changes will sit. NGG said they expected the rules to be within the relevant sections of the Uniform Network Code.

Determining load bands for paying NDM consumers

3.14. David McCrone (Ofgem) presented on the proposed load bands to be used to pay NDM consumers based on their type and consumption.

3.15. A participant asked how this approach fits with the VoLL figures as determined by the London Economics study and used in the past modelling conducted for the SCR by Redpoint. London Economics estimated a domestic consumer required payment of £30 for one day interruption, but that the proposals could result in consumers being paid more than this on a peak day if the proposed £14/therm figure is used in the manner presented.

3.16. Tom Corcut pointed out that the £30/day figure in the London Economics study referred to the payment a domestic consumer would require if they lost their gas supplies on an average winter's day (where typical consumption is 2.2 therms/day). The £14/therm was therefore calculated as 30/2.2 = £14/therm. The proposed approach to paying NDM consumers would then take into account the actual size of the interruption for the network isolation in question and pay consumers according to their estimated typical consumption on the day of interruption. On an average winter's day domestic consumers would be paid around £30 if interrupted, but on an extremely cold day they would receive more as their consumption would be higher.

Potential for trialling any DSR mechanism

3.17. Tom Corcut then moved on to a final question regarding the possible trialling of any DSR mechanism.

3.18. There was general agreement that trialling is probably desirable. One participant pointed out that trialling should be in a discretionary manner, similar to Operating Margins. They also suggested separating any DSR mechanism from cash-out reforms if timelines are tight. Another participant suggested completely divorcing and DSR mechanism from cash-out.

3.19. Anjli Mehta noted Ofgem would likely be opposed to divorcing DSR from cash-out. Once a DSR mechanism is implemented, then it would feed into cash-out following any trial.

Action	**Organisation**
Set out the pros and cons of different DSR response types (ie, turn down by versus use no more than a prescribed volume).	Ofgem
Clarify the trigger point from which DSR will be made available and possible impacts on the wider market.	Ofgem
Clarify concern on contingency payments and alternative proposals	Ofgem
Submit comments on the following points to the GB Markets mailbox by 23rd October (GB.Markets@ofgem.gov.uk). • NGG's alternative DSR proposal • Alternative payments to NDM consumers (which meet the criteria of maintaining incentives to flow gas and avoid being short, being simple and reducing the risk of large surpluses or shortfalls) • The proposed approach for managing shortfall	All