

**UNC Workgroup 0435 Minutes**  
**Arrangements to better secure firm gas supplies for GB customers**

**Monday 28 January 2013**

**Energy UK, Charles House, 5 – 11 Regent Street, London SW1Y 4LR**

**Attendees**

Tim Davis (Chair)	(TD)	Joint Office
Lorna Dupont (Secretary)	(LD)	Joint Office
Alan Raper	(AR)	National Grid Distribution
Antonio Ciavolella	(AC)	BP Gas Marketing
Charles Ruffell	(CR)	RWE Npower
Chris Wright	(CW)	Centrica
Claire Thorneywork	(CT)	National Grid NTS
Eddie Proffitt	(EP)	MEUC
Elsa Wye	(EW)	Statoil UK
Erika Melen	(EM)	Scotia Gas Networks
Gerry Hoggan	(GH)	ScottishPower
Jeff Chandler	(JC)	SSE
Julie Cox	(JCx)	Energy UK
Lorna Lewin	(LL)	DONG Energy
Mark Dalton	(MD)	BG Group
Richard Fairholme	(RF)	E.ON UK
Roddy Monroe	(RM)	Centrica Storage
Steve Catling	(SC)	Scotia Gas Networks
Tom Corcut	(TC)	Ofgem
Tom Farmer	(TF)	Ofgem

**1. Introduction**

TD welcomed all to the meeting.

**1.1 Review of Minutes**

The minutes of the previous meeting were accepted.

**1.2 Review of Actions**

**0435 11/03:** All to consider whether it would be beneficial for National Grid NTS to be able to contract directly with customers.

**Update:** Under consideration. **Carried forward**

**0435 12/02: Business Rules** - Consider what might be required for the development of an appropriate methodology for accepting offers.

**Update:** Under consideration; CT confirmed that at this stage National Grid NTS was clarifying its understanding. **Carried forward**

**3. Discussion**

**3.1 Ofgem Significant Code Review (SCR)**

Invited to give an update on Ofgem's plans for the parallel SCR discussions, TC reported that a DSR auction was being actively considered. A number of Workshops will be arranged, the first of which will take place on 04 February to consider potential options for changing cash out and mechanisms for a DSR

auction. (Prior to this Workshop a paper outlining some options would be issued.) The next one would probably be held in March, to consider a strawman for a DSR auction proposal. Discussions of Business Rules and detailed design would follow on from there, with a final decision around May time. A consultation and an Impact Assessment (IA) were likely.

Responding to questions, TC confirmed that work would dovetail with the DECC work on further measures, including any implications for storage; there was quite a lot of detail to be worked out and it was hoped to keep all developments fully aligned. It was likely that Energy Act powers would be used to implement any proposals.

Observing that Ofgem Workshops would at present run in parallel to these Workgroup 0434 meetings, CW asked if at some point these might be combined. TC indicated that, in Ofgem's view, the more widely spread the consideration and discussion the better; it may be concluded at the end of the process that Modification 0434 is or is not required in addition to any Ofgem proposals. Asked if the proposed implementation of October 2014 was still realistic, TC responded that the longer it is left the less likely this was achievable, pointing out that Xoserve needed sufficient time for planning and testing.

RF questioned if there would be impacts on the Safety Case. CT reported that the DSR auction concept had been discussed with the National Emergency Coordinator (NEC). At present it was not believed to have any impact, but this may depend on how it is finally structured.

### **3.2 Identification and Discussion of Options**

CW proposed capturing and redefining the range of options and views. This might also encourage the raising of alternative modifications if believed appropriate to allow different approaches to be considered.

Areas for consideration were outlined and a general discussion on the merits/demerits of each ensued, with TD populating an Option Analysis Table to capture the key items and respective advantages/disadvantages concluded from each discussion (published alongside these minutes).

#### *Supply Side Inclusion*

CW noted that the Workgroup's views were disparate regarding this. Some believed that incorporating the Supply Side could cause distortions. Others suggested some potential Supply Side gas would not necessarily respond to market signals but might see the SSR option as a suitable route to market when necessary to lessen the chances of moving into a Gas Deficit Emergency (GDE). CW explained how this would happen and what might be included. CT counselled caution; depending on what was called in to alleviate the position, would the Workgroup assent to option fees having to be paid? MD observed the route to market has to be carefully considered, and believed there were two reasons for not including Supply Side gas, ie the price curves are very different, and National Grid NTS would possibly find that it was losing sources of Operating Margins (OM) gas. CW confirmed that OM gas would be kept separate at this stage but combining procurement of Om with the new DSR product could be considered later. CT pointed out that National Grid NTS could be in a position where it has contracted for both services from the same source. MD thought it unlikely that National Grid NTS would put itself in that position. TD asked, why not? It was used in different circumstances and called on at different times, so the source could appropriately be paid twice for being available in differing circumstances. EP commented that would not be right, and there was something wrong with the system to enable such a position. TD then observed that supply sources could also be withdrawn from the market to enable it to be offered within this mechanism.

Responding to questions from EP, CW explained the option fee and exercise price and how this might work with National Grid NTS effectively buying the gas. It was noted that Gas Balancing Alerts (GBAs) have been called more often than the calling upon and using of OM gas. Depending on the bid curve and where a party sat as a customer may affect what a party experiences, and MD explained how he saw it would distort the market, with gas potentially held back awaiting a higher price under the SSR mechanism. EW added that in any such event National Grid NTS would want every party flowing gas to answer the call, and not be holding anything back.

AC briefly outlined what happened in the French market in such a situation, and then questioned how this might relate to the GB emergency arrangements. CT responded that a Gas Deficit Warning (GDW) was the proposed signal, and this was prior to an emergency. She explained the tools available for immediate response and as a last resort NTS would be exercising a number of DSRs to elicit increased market response. MD commented that it was buying real volume reduction; CW observed that it may already be 'off', eg a Power Station may already be offline. CT added that for the period between a GDW being notified and Stage 1 of a GDE, this was just an additional tool to enable the market to respond as a result of prices rising. MD saw Supply Side at the lower end and Demand Side above that in terms of price.

RM referred to Rough and cushion gas, which could be used if it was recognised to be a 'finite' quantity for use only to avoid an emergency; it would be expensive to utilise this but it could be done, helping to defuse the severity of an event and thereby contribute to the active prevention of something even more expensive happening. MD asked why cushion gas was not offered anyway? TC commented that it might not actually be legal under the terms of the Third Package to sell cushion gas. JC indicated that it might be possible through a Shipper. RM observed that Storage Operators should not participate in production activities, but there may be other ways to access this gas. CW commented that a lot of DSRs could take part in the process tomorrow. Perhaps some analysis should be done to see what the options are and if 'new' sources of gas can be called on to alleviate a GDE.

JCx asked how early access to cushion gas might be achieved. RM outlined some scenarios where there may be spare deliverability. JCx observed that this might create a monitor breach position and precipitate an emergency through a different route. This is clearly a valuable resource but how can it be accessed early enough to make a difference? TD suggested that the Business Rules might contain a statement indicating that at such a time the monitor would be suspended; this might require further consideration in respect of the Safety Case. RM commented that the provision of more Storage was being encouraged so there may be 2 or 3 facilities similar to Rough in the future, increasing the volume of cushion gas that might potentially be available. EP queried how volume could be released. RM thought deliverability could be increased but then you may have to top up from the market to meet your customers' requirements. JCx asked wouldn't you want to make that available year in year out to the market?

TD referred to the encouragement, and potential provision, of more storage or linepack, and asked why this should not be considered if it is more economic than DSR bids – similar to the DN interruption option of investing in pipes if more economic than interruption contracts. JC believed that this and various other options were being considered by DECC. RM asked would it give the revenue certainty that investors require – there may be the risk of stranded assets, or demand dropping off. TD questioned if this an argument for getting National Grid NTS having more linepack available if more economic than having DSR customers? The advantages and disadvantages were briefly discussed, noting that it can take 7 years to put pipes in the ground, and there would have to be lot of expense associated with DSR to match the cost of linepack investment.

TD asked MD to amplify his earlier observation on different price curves. MD suggested supply prices would be expected to be below the price where any DSR reduction kicks in. If the supply price were higher, sites will turn themselves off in any case. RF referred to the distortion of the market – what price National Grid NTS picked will affect the degree of distortion.

Referring to security of supply in Europe, RM outlined some scenarios whereby additional gas could make its way to GB through a SSR mechanism. TD commented that it may be easier to have a contractual route rather than a guaranteed physical one. RM observed that incentives to sign up to long-term contracts might result from an SSR mechanism.

Responding to a question from MD, CW indicated that auction design would be for a later discussion; a phased approach, with DSR utilised first, might be considered; or only the consideration of certain sources, eg cushion gas. This might require a legal view in respect of questions of discrimination regarding the provision of the service.

#### *DN and DN Customer Participation*

This had been discussed at previous meetings and CW reiterated the views expressed. EM believed that sufficient discussion had taken place and a conclusion reached that DN customers should be eligible. It was noted that DMs could participate in DN Interruption tenders, DSR, or both.

AR commented that potential consequences could affect a DN's investment decisions if the volume of interruption offered to DNs reduced. Both sets of circumstances were discrete and would be called off differently. EP observed that if a site was called off for DSR then the DNs position could be benefitted as being less likely to have to call off others.

AR and EM agreed with TD that it was not worth trying to write restrictive rules to obviate paying sites twice over with the chances of a transportation constraint and GDE coinciding being low.

#### *Communications and Contracting with National Grid NTS*

Customers' concerns regarding lack of visibility and confidence as to why they were being called off by Shippers were reiterated – giving a preference among some customers for directly contracting with National Grid NTS.

CT observed that the communication route appeared to be through a number of different parties to achieve contact and a result: National Grid NTS -> DN -> Shipper -> End consumer. For speed of response the best route was for National Grid NTS to directly contact the customer. SC pointed out that the DN and the Shipper would still need to be kept informed. CW asked, is additional communication complexity 'worth the size of the prize'? CT reported that National Grid NTS (Darren Lond) was looking at this and what was currently in place for the GDE process. CT explained how DNs were contacted and it was established how load needed to come off. CW commented that there were a lot of DN customers who might be interested in the process. EP referred to what had been lost under Modification 0090.

CW concluded eligible DN customers should be in scope; excluding them would not make sense.

#### *Who contracts with whom?*

Should National Grid NTS contract with end consumers, or should everything be facilitated through reliance on other parties?

EP observed that the DNs work through the Shippers, and SC commented that the Shippers decided which of their sites would come off. EW reiterated customers'

expressed preference for direct contracting with National Grid NTS; in their perception this would be easier to recognise that it was a physical rather than a commercial call off. EP was surprised that customers had apparently expressed such a view, and believed the contract should be with the Shipper. JCX suggested that disparate customer views may be due to individual perceptions/experiences; there might be an evident split in views between differing sizes of, or related to differing activities of, customers? EW asked what evidence might be required by a customer to verify the reason for call off. JCx pointed out that a GDW would be a public event with public information, so it should be very clear.

SC suggested considering time constraints on sites to relay within a set period of time information to the DN and Shipper that they had been contacted by NTS and confirmation of the action taken.

CT expressed concern regarding the effects on trades, suggesting that an understanding of current ECQ arrangements and its effects, might be learnt from and possibly emulated.

TD asked again, why not contract with customers? CW observed that the Gas Act prohibited National Grid NTS from buying/selling gas. The concept of buying a service rather than a commodity was briefly discussed. CT believed it would be complex and have to have a back-to-back arrangement with a Shipper to manage. EP believed this was trying to 'reinvent the wheel' and pointed out there were contractual arrangements and a procedure in place with the DNs; the Shipper does the bidding on their behalf.

EW asked if customers had expressed any views to Ofgem. TC confirmed that Ofgem had spoken with a few end customers and the perception of a lack of trust had been evident. However, TC indicated that it would be preferable for Shippers to contract with consumers, and not have National Grid NTS involved. TD believed that customers would be less happy to contract directly with National Grid NTS once Terms and Conditions and wider contractual terms were under discussion; the poor relationship perception appears to be more about visibility and transparency. Contracting might be easier through the Shipper, but unless perceptions change this runs the risk that the customer may then not be inclined to participate. TC commented that if the auction was designed sufficiently well then fears should be allayed as far as possible and this would encourage participation.

With regard to communications, EP believed that DNs already kept contact lists. JCx suggested that a phased approach to communication might be possible, eg to Shipper first, and then direct to customer.

#### *Volume sought and price cap setting*

TD summarised three possible options:

- Determine target DSR volume in advance
- Accept any offers up to price X
- Provide National Grid NTS with a fixed budget.

TC added there might also be appropriate hybrids of these, and all options should be identified for consideration.

EW drew attention to the capacity mechanism being developed on the power side, and believed that creation of any tensions between the two should aim to be avoided.

It was noted that OM was a target volume driven process.

#### *Fixed Volume*

This creates certainty. In response to questions from EP, CW explained how Modification 0435 was currently drafted, assuming a target volume is set by either

EU Regulations or DECC. Predictability would be increased if an industry agreed methodology for establishing the target volume was clarified for customers and was transparent.

However an inefficient price could be expected (there was no incentive for economic bidding, unless the volume is small). TD believed the Security standards were not really the right starting point, and suggested the aim is an insurance product, dealing with extremes rather than general security.

RM asked, what was the level of 'insurance' that the industry required? In DECC discussions this could be provided by Storage. Looking at the EU standard and declaring it is met today does not mean it is the wrong standard. CW observed it was for DECC to establish the Security standard and drive the need for the DSR volume.

RM commented that there was a need to make sure that it did not lead to an inefficient auction. Ofgem has said there could still be a gap between the SCR outcome and what is available – what extra is required? Revenue certainty over long periods of time is required for investment (e.g. by Storage developers). The present view of the investment community is that investment will not be driven by the SCR outcomes.

The link back to cash out to recover uncapped costs was a concern. EW observed that pricing that comes out of DSR will feed into cash out; this will be of concern so there needs to be some sort of efficiency trade off here. CW responded that potentially option fees would be socialised and only exercise fees set the cash out price, but this area needs more discussion.

#### *Providing a budget to National Grid NTS*

TD referred back to AC's suggestion, and AC explained why he felt this was worthy of consideration. Again, it creates certainty and lets the market clear. It could be adjusted and refined as appropriate, and would avoid excessive cost being incurred. The downside was that any budget was bound to be wrong at the outset and the initial outcome was therefore likely to be inefficient.

This was discussed. It was possible to see what was available, but who would set the budget and make the decisions? There may be no incentive towards economic bidding. A year on year escalator might be possible (hybrid); volumes are known in advance (DECC and National Grid NTS to establish?). Exposure could be capped through a budget. It could be a small volume for a lot of money.

TF believed that by establishing what the real purpose is, the correct approach could be taken. RM commented that getting DSR seems efficient but would not provide the complete solution.

TD summarised that the purpose was to avoid getting into a GDE; to prevent an identified adverse situation from escalating into an extreme position by prudently and proactively initiating and managing advance and orderly firm load shedding, but not irrespective of the cost.

CW noted that price at this stage of an event could be taken into account, whereas in a GDE it is not. RM commented that the market will deliver, but not necessarily when the policy makers want it to. JCx observed that electricity and gas may end up with different mechanisms, neither of which may run; as an industry, is there something we want to do before we get to a GDE, and make sure that it can and does run and bear the 'insurance fee' for having that level of comfort and assurance?

It was noted that had Ofgem not instigated a SCR, these discussions would not be taking place as the wider industry did not see security of supply as a risk and believed the market would deliver. However, the expectation is now that a standard

must be decided, a methodology be considered, and 'the gap' analysed and addressed.

RM added that Storage developments have been addressing market failure.

#### *Volume and price discovery*

Is it worth just holding an auction for price discovery? It was suggested there could be a fixed number as a target to aim for, and run the process either for a small volume or something bigger, which could then be capable of being adjusted and refined. There has to be recognition that the market is at risk, otherwise it is something that is not required.

CW pointed out that, as Proposer, he was only permitted to include one solution in this modification; other solutions would require the raising of alternative modifications by other parties.

TD asked, is a budget the best or worst thing to fix? Or should we just run the process, invite bids, and a committee decide what to accept? CW asked if both could be done. A minimum budget would at least encourage customer interest.

It was observed that a customer's ability or inclination to put in facilities for or to maintain alternative back up fuel capability cannot be prejudged. TD added it was not clear if the market was sufficiently large; if some can do it cheaper than others, then that will be discovered.

CW suggested a minimum budget, with a review in light of tender outcomes.

CT reiterated a need for a methodology agreed by the industry that National Grid NTS was able to follow appropriately.

TD referred back to a budget constraint, and described potential methodologies and how option/exercise fees might be taken up to reach volume at cheapest cost.

RF suggested a price cap; establishing the flexibility was the hardest part.

#### *Customer compensation*

##### (i) For those taking part and with bids accepted

It was suggested these customers would receive an exercise price for the duration of their interruption period and would continue to receive this until such time as they were able to reconnect. RF noted that Shippers would need to consider contractual terms when looking at the period to paid for.

If a site were not called off/interrupted then it would not receive payment.

The exercise price would, by definition, be based on market value.

CT was not sure how differing periods of 'offness' would be managed. CW suggested different VOLLs could be established for different periods and at different prices. JCx noted this was likely to add complexity to any assessment of the bid stack. RF observed that speed of deliverability might also be key to any assessment of order of call off.

##### (ii) For those taking part but with bids rejected, and customer is then interrupted

It was suggested that Ofgem could assess the bids, or the stack could be run (as for those who were accepted). TF raised concerns regarding the perceived complexities involved in any Ofgem assessment; a mechanistic process was potentially to be preferred.

There may be difficulties with running a post event assessment.

There may be a loss of incentive to participate in the DSR mechanism – the design needs to repel spurious bids.

JCx suggested a bar above which any claimant would have to demonstrate and justify that its costs have actually been higher than the compensation received (it would receive an exercise price only). Ideally it would be necessary to provide an incentive to bid an efficient price in the first place.

CT suggested that assessments could be made well in advance of any event because price and VOLL would be known two years before.

EW suggested the lowest cleared price minus X, so it would always be lower than if a party had bid successfully and participated.

CW questioned which party should be the assessor of bids. TF indicated that it might be difficult to work out what criteria should be used. CW referred to work carried out by London Economics, which perhaps could be drawn upon to benchmark VOLLs. This was briefly discussed and complicating factors were identified, making site specific considerations appear necessary.

JCx believed it to be better that a party participates and submits a high number, rather than not participating at all.

CW suggested that the lowest 50% get paid the VOLL they have bid into the process, and the 50% most expensive receive nothing. RF voiced concerns regarding the risk of over-inflated bids, and suggested compensating more like half the lowest bids. EW suggested looking at the bidding in proportion to their VOLLs.

TD noted tranche by tranche compensation was possible. CT expressed concerns regarding tranches; these would need to be capable of being measured/metered to validate that these phased turn offs had actually taken place. TD suggested there should be a minimum volume for a tranche size. CW agreed there might be a problem with measurement and validation if a site was not hourly metered, as only the end of day figure would be known. AR observed that in DN interruption there was a two-stage test – the hourly rate and the total daily consumption. TD noted that it would be a post event check; something like Failure to Interrupt (FTI) charges (of a significant magnitude) would need to be in place to encourage appropriate behaviour. CT added that National Grid NTS Operations need to know very quickly (and be confident) that there has been a response. TD reiterated that the right incentive for active performance was required.

Another suggestion was made that those with rejected bids receive nothing, however TC indicated that parties who shed firm load should receive some form of compensation.

Large numbers would preclude a case-by-case assessment for compensation.

A further suggestion was to include an appeals process, which could be used if a party felt its contribution had been undervalued/not fully compensated; this might require the payment of an administration fee in advance.

(iii) Customers who were eligible to take part but choose not to (but are then interrupted)

One suggestion was that they should receive no compensation.

Shippers could actively point out to their customers the benefits of participation and the risks of non-participation. RF suggested that a letter from National Grid NTS to sites advising of their position at the time of such an event, highlighting potential ineligibility for subsequent compensation, and directing customers to the Shipper for further information on how to participate. However, it was the customer's individual business decision whether to participate or not. There would be potential

increases in administration costs for Shippers and National Grid NTS depending on the level of communications.

Another suggestion was that these parties should receive some compensation for being curtailed. Depending on the default level on offer, this may be a (continuing) disincentive to participation.

(iv) Customers who were *not* eligible to take part (but are then interrupted), ie NDM and small DMs?

One suggestion was that they should receive no compensation.

Another suggestion was that these parties should receive some compensation for being curtailed, eg the same as for DN supply loss – around £30 - £40 per day. It would be difficult to establish an NDM VOLL. Administration and operation costs could potentially be high (switching all parties back on). CT suggested that the SOQ could determine the compensation rate. There was a preference for a flat rate compensation fee.

CW believed that NDM customer compensation had no part in this process, and could be dealt with separately by Ofgem through other mechanisms, eg Licence changes.

### 3.3 Next Steps

At the next meeting in February, it is anticipated that the following topics will be considered and discussed:

- Auction design
- Neutrality mechanism (under recovery/recovery of option fees)
- Bid Acceptance Methodologies.

## 4. Any Other Business

None raised.

## 5. Diary Planning

The next Workgroup meetings are planned as follows:

Date	Time	Venue
Tuesday 19 February 2013	10:30	Energy Networks Association (ENA), 6 <sup>th</sup> Floor, Bradley House, 52 Horseferry Road, London 2AF
Monday 25 March 2013	10:30	Energy Networks Association (ENA), 6 <sup>th</sup> Floor, Bradley House, 52 Horseferry Road, London 2AF

## Workgroup 0435 - Action Table

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Action Ref	Meeting Date	Minute Ref	Action	Owner	Status Update
0435 11/03	16/11/12	2.0	Consider whether it would be beneficial for National Grid NTS to be able to contract directly with customers.	All	Carried forward
0435 12/02	17/12/12	3.	<i>Business Rules</i> - Consider what might be required for the development of an appropriate methodology for accepting offers.	National Grid NTS (DL)	Carried forward