

# NDM Curtailment Compensation Fund

## Initial Thinking

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**centrica**  
energy

# Background

- Original SCR proposal sought to link Ofgem's chosen NDM compensation value of £20/th into shipper cash-out price
- But this risked establishing a market/forward curve at the same value, for the assumed duration of the emergency
  - All volumes unhedged at the start of the GDE could only be bought at that price on the market –the cost of this was not properly reflected in the RIA which accompanied the SCR
- Centrica believes that cash-out reform and NDM compensation are two completely separate issues and linking the two causes numerous problems, nevertheless
- Ofgem has indicated that any attempt at better securing GB gas supplies must also consider compensation to NDM customers whose supplies are interrupted
- At SCR workshop on 4 February Ofgem challenged the industry to develop a model for NDM compensation which might accompany cash-out reform proposals, therefore
- Following on from a conversation amongst Energy UK members, Centrica has given this some further thought

Essential to break the perceived link between compensation and cash-out

# There would appear to be two basic models for capped NDM compensation

- Central fund collected *ex ante*; or
- Supply licence condition to compensate isolated NDM customers, *ex post*

Core proposition	Pros	Cons
<b>Central fund collected ex ante</b>	<ul style="list-style-type: none"> <li>• Once built up, ensures money is available to compensate customers</li> <li>• Contributions manageably small if staged over a number of years as proposed</li> <li>• Relatively simple to implement and administer</li> </ul>	<ul style="list-style-type: none"> <li>• Ties up capital, therefore has a real ongoing cost</li> <li>• May never be used</li> <li>• May be seen as barrier to market entry</li> </ul>
<b>Supply licence condition to compensate isolated NDM customers</b>	<ul style="list-style-type: none"> <li>• No upfront cost to suppliers/customers</li> </ul>	<ul style="list-style-type: none"> <li>• Risk of under-compensation or smeared liability in event of supplier insolvency post emergency</li> </ul>

- On balance, we consider that an independently managed and suitably ringfenced escrow-type fund, collected *ex ante* from all NDM suppliers as a percentage of their individual NDM portfolio, might provide an acceptable solution

The following slides therefore describe how an *ex ante* fund might operate

# Amount of compensation

Keen to express this as a fixed figure rather than a per therm rate

- Customers will be compensated at £30 per event of network isolation
- Mirrors daily transportation interruption arrangements
- On a /th basis, this might typically be between £7.50 and £30.00. £7.50/th probably closer to LE's actual assessment of NDM VoLL than £20

# Overall size of fund

A fund of £150m would appear to be appropriate

- In order to assess the size of the compensation fund, where possible we have adhered to figures used in Ofgem's SCR analysis
- Ofgem assumes that under current arrangements, 101m therms of NDM energy would go unserved once in 167 years, with an NDM outage lasting 14 days. Therefore:
  - 101m therms divided by 14 days = 7.2m therms/d.
- Dividing this number of therms by average annual household consumption gives the number of households which would be isolated:
  - 7.2m therms divided by 1.54 therms/d = 4.7m households
- As a percentage of all households, this works out to:
  - 4.7m isolated households divided by 23m households in total = 20%
- We therefore propose that funds are collected to compensate 4.7m households at £30 = £141m (rounded to £150m for ease of reference).
- Dividing by peak consumption of circa 4 therms/d would give a figure of 1.8m households. Therefore, using average consumption as Ofgem has tended to do in its analysis provides a worst case, highest cost, scenario

# Collection of funds

- It is proposed that this fund is collected at an equivalent rate of 50p per NDM supply point, per year.

Therefore:

- 23m NDM supply points x 50p/a = £11.5m collected per annum

And:

- £150m divided by £11.5m/a = 13 years to accrue in full (ignoring accumulated interest on accrued funds)
- It is proposed that the fund is paid for only by suppliers with NDM supply interests
- No derogation is proposed for smaller shippers/suppliers i.e. all NDM suppliers will be required to contribute according to their NDM portfolio size – this accords with Ofgem previously stated view about “appropriate” market entry/participation
- Fund to be reconciled periodically (e.g. Annually) to account for market share movements

# Management of funds

Robust management and ringfencing of funds will be key to success

- Fund to be managed and administered by independent trustees, possibly a bank
- Fund would receive interest (Money in to fund), but would need to pay administration/trustees fees (Money out of fund)
- A process for appointing and overseeing the trustees will need to be agreed, possibly through a UNC ancillary document?

# Collective insurance

Following a GDE, funds will be paid out of the total pot, and not targetted at “short” shippers

- Mitigates previously expressed concerns about Force Majeure
- Necessary as I&C only suppliers excluded from arrangements (but they could be responsible for gas shortage)
- Avoids “throughput” re-targeting issue in the event of shipper bankruptcy
- Simpler to establish and administer than a targeted approach

# Payouts from the fund

- In the event of NDM isolation, Xoserve will, with the assistance of the transporters, identify the individual NDM supply points which have been isolated, and the shippers responsible for those supply points
- Back-to-back licence conditions will oblige the shipper to receive money from the central fund, and pass this to the relevant suppliers for onward transmission to end consumers
- If the extent of NDM isolation and associated compensation exceeded the funds held, a pre-arranged overdraft facility would be sought from the fund manager (e.g. the bank) to be paid back from additional funds subsequently collected from all NDM suppliers

# What happens next?

1. Concept (and any alternatives) written up and passed to Ofgem for development outside of UNC governance processes?
2. Incorporate within 435, recognising the need for separate Licence changes?
3. Separate UNC Modification raised (but would also need Licence changes)?