

## **Transco NTS Response to UNC Modification Proposal 0021 “Revision of the Emergency Cash-Out Arrangements”**

Transco NTS offers the following in response to Modification Proposal 0021 “Revision of the Emergency Cash-Out Arrangements” and proposed revised legal text.

### **Incentive Properties of Emergency Cash-out Arrangements**

Transco NTS notes that one of the priority areas for the Ofgem Cash-out Review Working Group (CORWG) within the Gas regime is the emergency cash-out process. Transco NTS believe that the creation of the Storage Safety Monitors and the potential for a Safety Monitor Breach to trigger an emergency, coupled with the information provided by Transco NTS regarding the status of these monitors, has made the potential of a Gas Deficit Emergency (GDE) more predictable giving the market more time to respond and create appropriate price signals leading up to the declaration of a GDE. Transco NTS has supported the view raised within the CORWG that the current arrangements might not provide the most appropriate incentive for Users to take all actions that might avoid entering an emergency or minimise its duration. Transco NTS has also supported the view, raised within the CORWG, that the current arrangements might have an adverse impact on so called “price sensitive” supplies such as flows into the system via Interconnectors and LNG importation. Any reduction in market prices resulting from a reduction in cash-out exposure in a GDE may result in price sensitive supplies being diverted from the UK to other markets where market prices were higher leading to an increase in the gas deficit and hence potentially exacerbating the emergency.

### **GDE Cash-out Price Determination: Single/Dual Price Cash-out**

Transco NTS believes that any change to the GDE cash-out price determination should seek to ensure that Users do not have a financial incentive to withhold gas from the system, i.e. the cash-out price for “long” Shippers should be comparable to, or lower than pre-emergency cash-out, but at the same time it should also ensure that Shippers do not have a financial incentive to withhold demand response, i.e. the cash-out price for “short” Shippers should reflect the full or marginal value of securing demand response. Transco NTS considers that these dual incentive properties can only be delivered via dual cash-out prices.

Transco NTS believes that Shipper balancing actions for a gas day will be influenced by the prevailing cash-out prices or an expectation of where the cash-out prices may out-turn and the Shipper's relative Cashout exposure. Based on this assertion, the most appropriate emergency cash-out prices, post market suspension, should be close to the prices that were prevailing at the time of market suspension. The proposition of using SAP as the sell price overcomes the potential for an earlier system buy action setting the sell price if prices are escalating within day; a scenario that may happen during the run up to a potential Gas Deficit scenario.

## **Cost Targeting in a GDE**

Currently, in the event of a potential Gas Deficit Emergency (GDE), Emergency Interruption would be used by Transco NTS under the direction of the National Emergency Co-ordinator (NEC) in an attempt to reach a system supply & demand balance and hence the deficit could be resolved. This could result in a scenario where a Shipper, which was "short" of gas going in to a potential emergency, might be brought into balance through the action of the Relevant Transporter calling Emergency Interruption. This might result in limited cost targeting in regard to those Shippers that contributed towards the potential emergency, which might weaken the financial incentive on the Shipper to contract for adequate supplies and/or demand response.

Associating a title trade with Emergency Interruption would, to some extent, correct this lack of cost targeting. If a trade were associated with the volume of Emergency Interruption, a Shipper that was "short" prior to Emergency Interruption would be financially exposed at the SMP buy price to the full extent of its pre-emergency short position. A Shipper that was in balance or long prior to Emergency Interruption would retain this imbalance position after Emergency Interruption.

## **Relevant Objectives**

The potential increased cash-out exposure risk for "short" Shippers associated with implementation of the Proposal could be mitigated by the Shipper contracting for a combination of increased supplies and/or increased demand response, and therefore NTS Transco believes that implementation of the Proposal will generate reasonable, cost reflective and economic incentives to promote compliance with the domestic customer supply security standards and hence will better facilitate relevant objective 1(e). Increased Security of Supply should lead to more efficient utilisation of the pipeline system and hence NTS Transco believes that the Proposal will also better facilitate relevant objective 1b); the coordinated, efficient and economical operation of the combined pipeline system.

## Benefits

Transco NTS believes that the Proposal;

- Introduces appropriate incentives through which Users are encouraged to make suitable provisions to avoid entering into a potential emergency situation or, minimize the extent or duration of such an emergency.
- Provides greater incentives for Shippers and Suppliers to manage their own portfolios and supply obligations particularly in regard to those consumers considered to be protected by the Safety Monitor.
- Ensures that the correct responsibilities and liabilities are in place to ensure that demand is managed appropriately, therefore may reduce the risk of a Gas Deficit Emergency (GDE), as defined in the Gas Safety (Management) Regulations 1996.
- Ensures that Users do not have a financial incentive to withhold gas as a result of the GDE cash-out price determination.

## Security of Supply

Transco NTS recognises that the prevailing emergency cash-out arrangements may have an adverse impact on the likelihood of “price sensitive” supplies (interconnector, LNG importation) continuing to be delivered in a potential or actual emergency as the prevailing Marginal prices are defaulted to a 30 day average price.

Transco NTS believes that the prevailing emergency cash-out arrangements also generate little financial incentive to action demand response as the financial exposure created by a “short position” and a benign cash-out price would be expected to be less than the costs associated with the volume of demand response that would balance a User’s portfolio.

Transco NTS believes that end-consumers would value demand response at a level significantly above 30-day average SAP. Given that the potential 1-in-50 annual volumes of demand and the expected supply level for the coming winter indicates a requirement for increased demand-side response, Transco NTS believes that under harsh winter conditions implementation of this Proposal would enhance Shipper and Supplier incentives to meet the Supplier Licence obligation to maintain supplies to domestic users.

## Interruption Payment

Transco NTS believes that Emergency Interruption in a potential GDE is a proxy for a Residual System Balancer national supply and demand balancing action and therefore it is appropriate that charges for such actions should be funded from energy balancing neutrality.

## **Interruption Trade Price**

If Emergency Interruption were initiated, a Shipper would no longer receive revenue from the relevant end consumer for gas delivered for that period of interruption from the interrupted sites. Under the prevailing arrangements Emergency Interruption would affect a Shipper's Imbalance and hence it would receive recompense for any lost revenue through the cashout process or through trading on any surplus gas. Transco NTS believes that for the purposes of this part of the Proposal 30-day average SAP is an appropriate level of payment for the Emergency Interruption trade price. A higher price might disincentivise a Shipper from entering into a commercial interruption arrangement with end consumers where as a lower price may not provide sufficient recompense to Shippers for the cost of the gas sold to the Residual System Balancer as a result of the Emergency Interruption related trade and lost profit from the sale of gas to the interrupted end consumer.

It is not intended that Transco NTS Emergency Interruption action will impact the order in which Market Balancing Actions are taken whilst the market remains open. Once a potential or actual Emergency has been declared, Transco NTS will be acting under the instruction of the NEC and will use all available tools, OCM or otherwise to manage the potential or actual emergency in accordance with our licence obligations and our GSMR obligations.

## Impact – Shipper Imbalance: Long/Short/Balanced

The following table demonstrates how Transco NTS believes Shippers would be impacted by the implementation of the Proposal given different levels of imbalance.

<b>Shipper Imbalance</b>	<b>Impact of Prevailing Arrangements</b>	<b>Impact of Proposed Arrangements</b>
Short	Shippers with a Short imbalance would face cash-out exposure at the relevant SMP price. Emergency interruption might reduce or remove the imbalance position and hence the cash-out exposure would be reduced or removed.	Imbalance position is unaffected by the Emergency Interruption. Shippers with a Short imbalance would face cash-out exposure at the final marginal buy price on the day. Shippers would receive a payment for the EIV based on 30-day average SAP.
Balanced	Shippers with a balanced portfolio would face no cash-out exposure. Emergency interruption would create a long imbalance position equal to the EIV and hence a cash-out payment would result or the Shipper could trade away this surplus position	Imbalance position is unaffected by the Emergency interruption. Shippers would receive a payment for the EIV based on 30-day average SAP.
Long	Shippers with a Long imbalance would receive a cash-out payment at the relevant SMP price. Emergency interruption might increase the imbalance by the EIV and hence the cash-out payment would increase or the Shipper could trade away this surplus position.	Imbalance position is unaffected by the Emergency interruption. Shippers with a Long imbalance would face cash-out exposure at the final marginal buy price on the day. Shippers would receive a payment for the EIV based on 30-day average SAP.

## **Impact on IS Systems**

### ***Emergency Cash-out Prices***

The Emergency cash-out prices changes can be implemented without any NTS systems impact.

### ***Emergency Interruption Volumes (EIV)***

Transco NTS can generate Emergency Interruption Volumes (EIVs) for NTS Supply Points such that an EIV for each User can be calculated and used as the basis for the EIV title trade. The calculation of the User EIVs will be dependent on Transco NTS having access to information regarding the Volumes of Emergency Interruption initiated by each Relevant Transporter. Transco NTS has commissioned an external assessment of the system generally used by other Relevant Transporters in assessing interruption volumes. This assessment concluded that they expected minimal costs to be incurred in adapting current systems to provide the information required. However, Transco NTS would welcome views from other Relevant Transporters in this area.

### ***Emergency Interruption Manager (EIM) Account***

The association of a title trade with Emergency Interruption could be facilitated by the creation of an Emergency Interruption Manager (EIM) account on AT Link. This account would be used to generate the title trades on a Shipper aggregated basis. Each Shipper would be deemed to have completed the trade with the EIM entering the disposing trade on behalf of each Shipper. The EIM account would mirror the balancing operator account in that it would not attract imbalance charges and would not be part of the Energy Balancing Smear process.

### ***Legal text clarification.***

During the consultation period Transco NTS received requests for clarification of a number of areas of the Proposal and associated proposed legal text. The areas of clarification sought were:

- Is the Emergency Interruption trade a Market Transaction - and specifically does it therefore feed into System Clearing Charges
- What type of Emergency would the Proposal apply to - i.e. does it include a Critical Transportation Constraint emergency
- Are such trades treated the same as other types of trades at the point of market suspension.

In an attempt to address these requests NGT have reassessed the legal text with a view to adding further clarity. Transco NTS consider that the changes made to the text do not change the nature or intent of the Proposal but rather add clarity to the treatment of the trade in relation to charges. The revised legal text provided with this representation highlights the changes made.

## **Summary**

For the reasons outlined in this response, Transco NTS supports the implementation of this Modification Proposal.