

**Representation For. 0021**  
"Revision of the Emergency Cashout Arrangements"  
Version 1.0

**Date of Communication:** 01/07/2005  
**External Contact:** Garth Graham (Scottish And Southern Energy plc)  
**Slant:** Against  
**Strictly Confidential:** No

**Abstract**

Dear Julian,

**Draft Modification Report 021: Revision of the Emergency Cashout Arrangements.**

Thank you for providing Scottish and Southern Energy plc with the opportunity to comment on the above draft modification report.

*[Note: We make no comment on the Legal text update provided circa 24 hours before this submission was due in, except to say that it was extremely late in the process to be providing such an update and it reinforces the comments we make below, namely that further details (from the Proposer) are required before market participants are able to provide a comprehensive response on this Modification Proposal. ]*

Our comments are in two parts; firstly in respect of the process and secondly in respect of the Modification.

Before looking at these in detail we wish to record our concern that the Draft Modification Report does not appear to bring out the issues that need to be considered as part of the consultation process.

Process: CORWG

We note the comments in Section 1 of the Draft Modification Report with respect to the workings of the Cash-out Review Working Group. As participants in the CORWG we are somewhat surprised that the Proposer seems to have come to such definitive conclusions (which warrant an urgent Modification Proposal - 021 - being raised) when neither the CORWG or Ofgem have come to any definitive conclusions with respect to cash-out.

As you may recall the CORWG was 'suspended' by Ofgem just before Easter, and has still to restart. Prior to this the group considered a number of issues that relate to cash-out, including gas emergencies. However, the group had neither concluded its overall deliberation of all the interrelated issues associated with cash-out nor come to any conclusions on the suggested way-forward.

Nevertheless this has not prevented the Proposer from selectively quoting (from a still to be completed process) in seeking to justify urgent Modification proposal 021. We feel it is premature, and somewhat unhelpful, for the (CORWG) process which was initiated by the Authority (to which industry parties provided significant resources) to be 'used' by one party to justify a major change that directly relates to the outcome of the (CORWG) process itself.

A further consequence of this Modification, it would seem, is to fetter the discretion of Ofgem with respect to the deliberations and outcome of the CORWG. Given that CORWG is 'suspended'; it seems highly likely the Authority will be asked to give its views on the gas elements of cash-out (by virtue of having to urgently consider Modification Proposal 021) without itself having reached any conclusions on the outcomes of CORWG. In addition this Modification proposal is itself incomplete in that a number of aspects have not been thought through, particularly in relation to the calculation of EIV and the Draft Modification Report doesn't sufficiently draw out all the issues associated with the proposed changes.

We also note (despite the need for 'urgency') that the Proposer, who could have debated this proposal at the 2nd June Transmission Workstream meeting, didn't even mention that the proposal had been sent to Ofgem as urgent, despite the fact that emergency arrangements were on the agenda for that meeting.

#### The Modification

One of the side effects of the Proposers' premature action (about the deliberations and final outcome of the CORWG process) is that this less than complete proposal (021) has been put forward. The urgent Modification proposal (021) is built on a 'it might do this/it might do that' basis which, in turn, raises more questions than it answers.

In this respect it seems there is a pattern emerging of urgent proposals being put forward (in both the gas and electricity areas) in the late spring/summer which have the potential to profoundly alter the fundamental operation of the market. As 'urgent' propositions they are hastily progressed through the change process with the time for consideration and debate curtailed. It seems that at a later date amendments are then put forward to improve on these initial 'urgent' propositions which could (or should?) have been addressed at an earlier stage had time allowed. It is for this reason that we welcomed the CORWG process as it proceeded in a structured, considered, comprehensive and fully inclusive way to address the issues associated with cash-out in both gas and electricity (as well as the interactions between the two markets).

It is not clear in the Draft Modification Report whether urgent Modification proposal 021 provides any stronger incentives than the status quo. It is worth restating that market participants are under a statutory duty to operate in a way that maximises available gas. There is, in this context, no financial incentive (via cash-out prices) for them to do or not do this. Therefore altering cash-out prices (for the suggested purposes of maximising gas availability) will no better achieve this goal than the current statutory requirements. As an aside the inference with this Modification is that the existing statutory obligations placed upon shippers are not working; however, no evidence is provided within the Draft Modification Report to substantiate this assertion.

We also notice that there has been no specific request, within the Draft Modification Report, for views on the EIV recalculation methodology.

In respect of the questions posed our answers are as follows:-

#### **1 In respect of the proposed amendment of Emergency Cash-Out prices from the prevailing single price of the 30 day average SAP to dual prices set at the point of market suspension:**

##### **a. Would the application of the proposed dual Emergency Cash-Out prices be set at the appropriate relevant price?**

No. Firstly, it is not really a 'dual' price as on one side the price is penal (prevailing SMP) and on the other neutral (30 day SAP). It is noticeable that the CORWG refers to cash-out being based on a principle of a party being held 'neutral'. However, urgent Modification proposal 021 seeks to move to more penal cash-out (the prevailing SMP Buy) when a Shipper is short.

In addition urgent Modification proposal 021 is based on the assumption that the risk that Parties could be exposed to (the prevailing SMP) could encourage Shipper to balance. However, this is undermined by the total lack of clarity, within the draft legal text on, for example:-

- i). how the SMP Sell price is calculated; and
- ii) the time at which the emergency cash-out price would apply.

In respect of (i) there is a reference to "F1.2.1" - its not clear why this is so and in respect of (ii) is it at the time of market suspension OR the day on which the GDE started, as these could be different days.

Secondly, it needs to be recognised that emergencies, by their very nature, maybe different, depending upon circumstances. Some are 'progressive' in nature; for example, a general deterioration in the (forecasted) weather situation; whilst others are 'sudden'; such as an explosion (caused perhaps accidentally or deliberately by those seeking to cause harm). For a 'progressive' emergency it maybe that the market could, in an ideal world, be able to react in the way that appears to be envisaged by this modification proposal.

However, for a sudden event (such as the immediate loss of a major terminal site) there will be little, if anything, that the market can do to prevent a GDE occurring. In this situation it seems both excessively harsh, and counter to natural justice, to penalise certain market participants by way of the prevailing SMP and yet also penalise those that are making a positive contribution by only paying them the 30 day SAP.

We note that one of the suggested advantages of the Modification is it:-

"Provides greater incentives for Shippers and Suppliers to manage their own portfolios and supply obligations."

However, this is predicated on the assumption that participants are realistically able to react to these incentives. In a 'sudden' emergency situation it maybe highly unlikely that market participants will be in a realistic position to react before a GDE is declared.

Therefore we do not believe that the proposed dual Emergency Cash-out prices will be set at the appropriate relevant price.

Thirdly, the Modification proposal does not address the fact that the rules of the market require parties to balance by the end of the gas day. Therefore, in the scenario that an event occurs early in the gas day, and is of short duration, a party that was in balance before and during the emergency, but later goes out of balance, could be penalised even though they have, in respect of the emergency itself, had no discernible negative effect on the emergency situation at hand.

**b. Does the industry anticipate any increased risks associated with the increased exposure to the prevailing SMP buy price, at market suspension, during an emergency?**

Yes. As noted in our comments to 1 (a) above, in certain emergency situations market participants maybe unable to react to mitigate the significant additional risk that the proposed exposure to the prevailing SAP brings.

In this respect the lack of 'immediate' information (a few hours, rather than days later) means that some market participants could be at an inherent disadvantage in terms of knowing what their actual (physical and thus financial exposure) position is (within the trading timeframe) due to the extreme prices (prevailing SMP) and associated volumes that they could be exposed to. Without this data they will find it extremely difficult within the day to accurately quantify their true exposure position. This, in turn, could lead, 'on-the-day', to the credit position of certain parties being 'squeezed'(\*) which, in turn, could force

certain parties to curtail (or even cease) their market trading activities (with the potential for serious implications for market stability, liquidity and competition). Given that the parties concerned may have acted (up to the point of the emergency event) in a reasonable and prudent manner, it seems harsh (and counter productive, in terms of seeking to increase the availability of gas) to victimise those parties

\* For example, if St Fergus were to be lost (due to a 'sudden' emergency) the market would assume parties are out of balance (by a theoretical figure of circa 40%?) and are thus exposed to the prevailing SMP for that volume which, in turn, uses up all the party's available credit with its counter parties.

**c. Does the introduction of such a mechanism set an appropriate level of incentive that ensures both Users and Transporters take every step through which an emergency may be averted?**

No. As noted in our answer to 1 (a) and (b), depending on the cause of the emergency, Users and Transporters may be unable to react to events, irrespective of the "level of incentive". It should also be pointed out that the Proposer has (in seeking to justify this Modification) made liberal references to the workings of the CORWG. However, in so doing the Proposer appears to have (conveniently?) overlooked the comments of CORWG (at its 4th February meeting) that:-

"Most of the group recognised the importance of having a neutral price when the market is effectively 'broken'."

However, it seems that when "the market is effectively 'broken'." the Proposer is seeking to introduce a penal mechanism to which market participants maybe unable to realistically respond.

Furthermore, we do not accept the Proposers' logic (vis incentives) namely that those parties which are long will only receive 30 day SAP (we believe this will provide a diminished incentive to go long) whilst those that are short pay the prevailing SMP (we believe that in an emergency that price, on its own, is less relevant; rather we think that in an emergency equilibrium is needed).

Also, what happens to the differential between the 'short' parties (charged at prevailing SMP) and the 'long' parties (paid at 30 day SAP)? Presumably this feeds through to Neutrality which means that this Modification proposal will lead to 'windfall losses' and 'windfall gains' for parties for doing nothing.

In addition to our comments above:-

"in the scenario that an event occurs early in the gas day and is of short duration a party that was in balance before and during the emergency, but later goes out of balance, could be penalised even though they have, in respect of the emergency itself, had no discernible negative effect on the emergency situation at hand."

it should also be pointed out that in a similar proposal within the electricity market (Balancing & Settlement Code Modification Proposal P173, proposed by NGT) it was stated that:-

"NGC also believe that the wider Industry should similarly not be exposed to losses or gains resulting from a 'relevant emergency instruction' through any consequential impact on Industry cashflows, including NGC's Balancing Services Use of System Charges. This (P173) Modification would only pass through those costs that would have reasonably and prudently incurred as a result of the change in Exports and/or Imports caused by the 'relevant emergency instruction'".

It is not clear to us that NGT is being consistent in its arguments on the matter of cash-out arrangements surrounding emergency situations (between UNC Modification 021 and BSC Modification P173).

Whilst we accept that in certain limited circumstances this proposal might provide greater incentives on Shippers to take actions, this does depend on the speed at which GDE happens. For example, last winter the interconnector continued to export on high priced days.

Furthermore we don't think it is accurate to say that it will incentivise parties to avoid an emergency as the emergency may well not be within their power to avoid.

**2. In respect of the introduction of a new Emergency Interruption Volume title trade and associated 'trade' payment:**

**a. Clarity on the methodology relating to the calculation of EIV would assist the development of this Proposal and views on this methodology are requested.**

Yes, we agree that "clarity on the methodology relating to the calculation of EIV would assist the development of this Proposal". In this respect we are disappointed that there was no clear request for views on the methodology presented at the 15th June Transmission Workstream meeting. We are also extremely concerned that the methodology is not included within the Code and we see no cohesive reason why it should not be included, rather than being left to the Transporter's discretion.

Furthermore, it is not clear if the proposed methodology for calculating the EIV will be based on day-ahead or within-day data; or over what period of time will the "historical consumption" be (that is used by the Interruption Manager to quantify the interruption volume)?

Also, if emergency interruption is requested day ahead, what would the price be? And, how would the volume be calculated?

This will create additional work for the agent at SSMPs in deriving the EIV which doesn't seem to have been considered in the Draft Modification Report. To provide information back to the Transporter within an hour is an onerous obligation on the Shipper, particularly when the timescales seem to be more relaxed for Transporters than for Shippers at SSMPs - why?.

In respect of the methodology outlined in Section 3.2 of the paper (entitled "Emergency Interruption Volume title trade Volume Calculation Methodology v0.7") presented at the 15th June Transmission Workstream meeting, using data from the previous day would be inappropriate around the days surrounding weekends, public holidays etc.

Finally, regarding the proposed Legal text, it doesn't appear to take account of new responsibilities shared by Transporters following the recent DN sale. The reference in 6.1.1(c) (in the second line) to "Transco NTS" should read "Transporter".

**b. Is a 30 day average SAP an appropriate 'relevant price' for trading the emergency interruption?**

We appreciate the principle that the proposal is trying to achieve; namely to hold a Shipper neutral in the event of an emergency interruption. However, it is not clear if the purpose of the change is to carry out the equal and opposite trade in order to (i) provide compensation or (ii) to influence cash-out prices? Clarity of which (i or ii) is required as it is clear the proposal cannot meaningfully achieve both.

For example, it appears that under this proposal that trade volumes and prices will be treated as market balancing actions and therefore will feed into cash-out prices. This raises the question, "is this supposed to encourage more demand side response"? If so, then clearly pricing of these 'trades' is important. However, these potentially large volumes could have an influence on cash-out prices within day. As the 'compensation' to be paid to those parties that are 'long' is based on the 30 day average SAP if the within day prices are not included (in the 30 day SAP) then the 30 day SAP might not be market reflective or

adequate compensation those 'long' parties on the particular day. Indeed it could be said that by excluding within day prices (from 30 day SAP) that cash-out prices have been 'dampened' down to an artificial level. If there is a dampening effect on within day cash-out then parties might not be encouraged to undertake the 'right' behaviour i.e. for shippers with firm large loads to 'interrupt' to help the system and avoid a stage two emergency.

On a related point if the trade is merely supposed to hold the shipper neutral then why is it necessary to make the payment at all - why not make it at zero price?

It is also unclear why, if the aim is merely to hold the party neutral, why the payment has to be determined on the day (with the onerous requirement to provide data within an hour). If it is simply a compensation payment then it doesn't need to feed into cash-out price derivation.

**c. Does the industry anticipate any increased risks associated with applying the EIV to the User imbalance? Does the industry anticipate any issues relating to its ability to avoid such risks?**

Yes. For the reasons outlined above, risk will increase significantly (whilst parties may be unable to realistically deal with the enhanced risk at the time, due to the nature of the event that has given rise to the emergency).

The second part of the question posed here is predicated on the assumption that parties will be able to avoid such a risk. However, for the reasons we have outlined above, we do not agree with that assumption as we believe that, in certain circumstances, parties will be unable to avoid such risks.

In addition it raises the question of how will the Shipper be able to validate the trades made against his portfolio for reconciliation purposes? The proposed Legal text infers one trade per shipper – but we believe, as a minimum, that the Shipper needs to see each EIV for each supply point.

What is the process if the volumes are incorrectly calculated? We note that (against the prevailing tide: such as the appealability of Ofgem decisions) there are no means for a Party to appeal against the "reasonable estimates" of the Transporter (rather than "Transco NTS" referred to in the draft legal text).

**d. Could the Proposer please provide examples of a User Emergency interrupted from a Balanced, Long and Short position.**

This reinforces the comments we have made above, namely that further details (from the Proposer) are required before market participants are able to provide a comprehensive response on this Modification Proposal.

That concludes our answers to the questions posed.

We note that the status of Modification proposal 0740a is still uncertain. If this proposal is approved then NGT will not have the right to interrupt for supply/demand reasons. Does this then call into question whether NGT should have emergency interruption right at all? If, however, the right to undertake supply/demand interruption is maintained, how many sites that could potentially be emergency interrupted already have been interrupted (for supply/demand reasons) and will Parties also receive compensation (based on the principles in Modification proposal 021) for the beneficial contribution attributed to this supply/demand interruption?

We note also that NGT has not brought forward any proposed changes (either 'urgent' or otherwise) to the System Management Principles Statement to provide for NGT to use the market first (prior to calling any emergency or supply/demand interruption). We are concerned that this change, which was supposed to have taken place following consultation last year, has still to be brought forward.

0021 SSE plc.doc

Finally, where, in the Draft Modification Report, is the impact assessment on UK Link and AT Link?

In conclusion we believe that the Proposer has selectively quoted from a still to be completed (CORWG) process to seek to justify a proposal that is therefore premature and not fully developed or complete and, as a result, the consequences (of the suggested changes) have not been fully thought through or considered. Accordingly Modification proposal 021 should not be implemented and, on this basis, we cannot support it at this time.

I hope that these comments are helpful. Should you wish to discuss any of the points raised in our response, please do not hesitate to contact me in the first instance.

Yours sincerely

Garth Graham  
Scottish and Southern Energy plc