Paper to the Transmission Workstream

Emergency Gas Cash out
Keeping the OCM open in a Network Gas Supply Emergency

Introduction

At the Gas Emergency Workshop meeting, chaired by Ofgem, APX raised the possibility of keeping the OCM open during stages 2 and 3 of a Network Gas Supply Emergency (NGSE). A group comprising representatives from APX, E.On, National Grid and Statoil volunteered and were actioned by Ofgem to progress this issue further. This note summarises the status of discussions to date and seeks the workstream's view on the way to take the outstanding issues forward.

Background

As the UK becomes increasingly import dependent concerns have been raised that upstream supplies to the UK cannot be maintained at a sufficient level to meet demand requirements resulting in a Network Gas Supply (Gas Deficit) Emergency NGS(GD)E. The potential to keep the OCM open, during stages 2 and 3 of a NGS(GD)E, was considered by this group, with a view towards encouraging incremental gas to continue to flow to the UK.

In the event of a declaration of a potential or actual NGS(GD)E the NEC, in consultation with the transporters and other relevant bodies, would determine the emergency strategy and coordinate a response to minimise the possibility of a supply emergency from developing, and where one develops, for minimising the extent and or duration of such an emergency.

The Network Emergency Coordinator (NEC) has identified 5 clear stages to manage a NGS(GD)E, with a view to providing a measured, appropriate and coordinated response. The NEC may declare the stages sequentially or simultaneously, to address the supply demand imbalance.

For this type of emergency the Uniform Network Code, Section Q 3.2.2 (c) suspends the OCM during stages 2 and higher. The cash out prices prevailing at the time the NGS(GD)E then apply for the duration of the emergency. Even though the OCM is suspended, shippers can continue to trade bilaterally and submit trade nominations during stages 2 & 3.

Proposal

The proposal being considered by the group was whether there was merit in keeping the OCM open during stages 2 & 3 of a NGS(GD)E. Consensus was reached, with respect to the principle that that there was no reason why the OCM should not remain open, in order to provide another route to market for shippers during an emergency. Keeping the OCM open would aid transparency and facilitate trading.

However, there were other key issues identified in the meeting. These were whether or not NGT should participate in the market, (in terms of procuring gas), the mechanism for setting cash-out prices, and the need for underwriting to facilitate trading and subsequent clearing processes.

Group Discussions

National Grid's use of the OCM

NGT have stated that, under an emergency, they have a criminal obligation under the Gas Safety Management Regulations to maximise their available system management tools to prevent, or reduce the severity of, an emergency and so will be obliged to pay any price for incremental gas. Their economic and efficient licence obligation, with respect to buying gas is therefore of secondary importance to public safety.

NGT have indicated that they would not seek to use the OCM as an operational balancing tool, because during such emergencies, the system is being physically balanced by the actions of the NEC and as such there would be no "residual balancing requirement".

There was an alternative view that if the gas was available on the OCM National Grid as the residual balancer should buy that gas.

Cash-Out Prices

UNC Modification 0044: Revised Emergency Cash-out & Curtailment Arrangements, changed the UNC so that the emergency cash-out prices were set at the imbalances prices prevailing at the point of market suspension. The preceding arrangements had prices set on the previous 30 days System Average Price (SAP) which Ofgem determined did not provide strong enough incentives to procure gas or demand side response from market sources.

Under the current arrangements, if the emergency continues for several days the cash-out price determined at the start of the emergency may no longer be reflective of the value of gas, which could in turn lead to perverse incentives arising. For example, if the value of gas continues to rise, shippers will have no incentive to balance their own position, as the cash-out price will be more beneficial.

If the OCM were to be kept open, and the cash-out prices were calculated on the normal (non-emergency) basis, they would follow the value of gas throughout the duration of the emergency, providing a dynamic cash-out price and maintaining the incentive on shippers to balance their own positions.

Attracting non-UKCS Gas

At Stage 2 of a NGS(GD)E emergency, shippers may be requested to maximise beach gas supplies. Any such direction, however, would only be applicable within the UK. It is therefore important to ensure that the correct incentives exist to encourage non-UK gas to flow to the UK and, moreover, to ensure that the current arrangements do not in any way impede the flow of incremental gas in a NGS(GD)E. It follows that the market price needs to be attractive, and the producer needs to be confident that they will be paid.

The party doing the buying will be doing so under its "obligations" under GSMR regardless of whether this is National Grid, shippers, or an agent. Under such obligations the amount paid is a "second order" concern, to the potential of criminal proceedings for non-compliance, but still one that needs to be resolved if the seller is to have sufficient confidence in being paid for the gas made available.

The OCM is a fully collateralised market, shippers are not able to buy on the exchange if they do not have sufficient collateral lodged with APX for the full contract value. This allows sellers to have confidence that they will paid for their gas. A shipper selling gas under other commercial arrangements may have a different level of risk and will obviously be influenced accordingly.

Selling through the OCM may provide comfort that payment will be received, however, this all relies on shippers having sufficient credit in place to trade on the OCM. APX would be in breach of its FSA obligations if it were to let trades take place that were not backed by sufficient collateral.

An alternative for shippers would be to ‘spill’ the gas on to the system, with any gas “cleared” through Balancing Neutrality at SAP. Full payment at SAP is not guaranteed if shippers start to go bust, as initially there may be an insufficient amount recovered through neutrality charges to pay for the gas in full.

In addition, any costs incurred by National Grid in balancing the system would feed through into neutrality, which may result in sellers having to pay a proportion of these costs, thus reducing the payment they receive for their gas. However, this only occurs if the cash-out prices are set too low and the industry collective insurance scheme is effectively being utilised. If cash-out prices are set on the marginal action, shippers are likely to receive money back through neutrality.

There is potentially an issue of underwriting if imports start to disappear and other shippers begin to fail, potentially creating a domino affect, and shippers are therefore unlikely to be able to underwrite their trades.

There was also a view that any procurement of 'non UK' gas by NG for the benefit of 'UK plc' is essentially a political choice and therefore this process should be both triggered and underwritten by the Government. The Joint Response Team could for example authorise [the NEC to direct] NGT to place locational bids on the OCM. The questions remain: could NGT be authorised to trade on the OCM, and under what circumstances?

Conclusions

The group was primarily set up to look in to the possibilities of keeping the OCM open during an emergency, and there was consensus that keeping the OCM open would provide an additional route to market, aid transparency and facilitate trading. To that end National Grid has raised the draft modification: “Gas Emergency Cashout Arrangements: Keeping the On the Day Commodity Market open during a Gas Deficit Emergency”.

Whilst the primary focus of the group has thus been discharged, the group did have some additional concerns particularly about underwriting of trades, particularly in a sudden emergency (e.g. a terrorist attack) and the way cash-out prices are set and the subsequent impact on neutrality payments. The Transmission Workstream is invited to consider the appropriate forum to progress these issues.