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

Tuesday 19 February 2013

Energy Networks Association, 52 Horseferry Road, London SW1P 2AF

Attendees

Tim Davis (Chair)	(TD)	Joint Office
Lorna Dupont (Secretary)	(LD)	Joint Office
Alan Raper	(AR)	National Grid Distribution
Anjli Mehta	(AM)	Ofgem
Antonio Ciavolella	(AC)	BP Gas
Charles Ruffell	(CR)	RWE Npower
Chris Wright	(CW)	Centrica
Claire Thorneywork	(CT)	National Grid NTS
Darren Lond	(DL)	National Grid NTS
Fiona Strachan	(FS)	Gazprom
Jeff Chandler*	(JC)	SSE
Julie Cox	(JCx)	Energy UK
Mark Cockayne	(MC)	Xoserve
Mark Dalton*	(MD)	BG Group
Richard Fairholme	(RF)	E.ON UK
Shelley Rouse	(SR)	Statoil
Steve Catling	(SC)	Scotia Gas Networks
Tom Farmer	(TF)	Ofgem

**via teleconference*

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; DL added that any suggestions as to what should be included would be welcomed. **Carried forward**

2. Discussion

2.1 NDM Customer Compensation

In its SCR, Ofgem has indicated to the industry that any proposal to improve the acquisition of GB gas supplies and add to security of supply must also consider compensation to NDM customers whose supplies are interrupted in the event of a GDE. An NDM compensation value of £20 per therm was proposed through the SCR and linked to the Shipper cash-out price.

2.1.1 Energy UK Presentation

JCx gave a presentation on NDM compensation in the event of involuntary interruption during a Gas Deficit Emergency (GDE). At its recent Round Table meetings, Ofgem had indicated that it expected NDM compensation to form part of the package of proposals that will be implemented. In previous meetings the industry had highlighted its concerns regarding the potential effect this would have on the market.

Two options were considered and discussed in turn.

Supplier Licence condition

A Licence condition to pay compensation could be included in the domestic supply licence. This would have the advantages of involving no upfront costs that may be passed to customers, would be simple to implement, and would avoid Market distortion. A speedy payment would be made to the customer, perhaps as a credit on their next bill.

However, there may be many questions around targeting costs and potential risks. The compensation would potentially be paid by parties not responsible for causing the emergency, and proving fault might be both difficult and subject to legal challenge.

RF asked what payment timescale was adhered to by the DNs for failure to supply gas (FSG). AR believed any compensation had to be paid relatively quickly, and that National Grid Distribution aimed to pay this direct to customers within 14 days, but he would check the details. SC reported that Scotia Gas Networks paid within 20 working days (for incidents involving up to 30,000 domestic customers).

Action 0435 02/01: *NDM Customer Compensation* - Check details of payment timescales adhered to by the DNs for failure to supply gas (FSG).

RF observed that when considering the potentially enormous scale of a GDE, this may require some form of validation and an assessment of whether there was enough money available capable of being distributed. Suppliers could be obligated to pay up front and recover monies after the event from those parties deemed to be held responsible.

JCx reiterated that the concept of the obligation to pay the customer should not be linked to cash out; it was a potential cost to any business operating in the domestic supply market today, with no upfront fund created to call upon.

CT said that there was an assumption that the DNs would already have a plan as to what sites would get called off first, and were therefore potentially more expensive to supply. SC described how SGN would approach load shedding and how different choices would be made taking into account various diverse factors to achieve the percentage that had to be shed. CW asked AM if a Supplier would be allowed to price some sites differently if these were viewed as ‘more expensive and risky’; would this raise issues of an inferred subsidy? Suppliers would not necessarily know which these were and Shippers felt any variations in supply prices to be unlikely

SC explained that firm load shedding would already have taken place (based on size of loads, i.e. generally large loads first), then sectorisation (shed a percentage and shut down accordingly); it depends what the problem is (transportation or supply constraint) and where. Ease of restoration would also be taken into account in any decision, ie more likely to choose to shut down around the periphery of a large conurbation, rather than within it. Discussions at the Gas Task Group are continuing. CT expressed a personal view, as a consumer, that she would rather have some energy than no energy. If fully isolated, an engineer would be required to reconnect. A day without rather than a month without was to be preferred, and is an argument for getting a CCGT back on to provide electricity for small consumers. CW commented that in previous discussions DNs thought they would have a very clear idea of which parties a sector isolation would affect. AR explained that the Sites & Meters database would be analysed and in principle this should provide a quick identification of those affected and enable the rapid passing of the information to Suppliers for action.

TD asked the group if they thought this option was a good one. Different views were expressed. JCx pointed out that Suppliers could create and put aside their own 'funds' or they could choose to take the risk and the 'hit' should the event occur; it was an individual business decision how any such perceived risk should be managed (perhaps it could be covered by insurance).

AM said that cash out is a balancing action and it was important that an incentive is created, giving appropriate signals to attract gas. RF argued the mechanism to compensate customers if interrupted is separate to cash out. TF then explained Ofgem's thinking on its proposals and that reflecting costs to NDM customers in the cash out price provides an important incentive to avoid NDM interruption as well as funding compensation; any approach that does not feed costs into cash out needs to ensure it creates the right incentives.

CW suggested there was a need to find the point where no gas will be coming in irrespective of the cash out price; he believed that the suggested £20 VOLL created market distortions, and pointed out that this problem can also be exported. MD agreed with CW and suggested looking at OM gas for precedents.

TD sought views on whether cash out and NDM compensation could be separated. RF observed that this option is primarily compensation for domestic customers. Once the DSR auction is exhausted, the market is broken and compensation could run in parallel, with DSR prices setting cashout. CW also believed cash out could be dealt with separately from domestic compensation and explained why; bringing an inflated compensation figure into cash out was the nub of the problem. JCx added that keeping the market open (never freezes) was supported at discussions. CW believed that would be another topic for a later discussion.

CW commented that there were existing obligations for Suppliers to compensate domestic customers in various circumstances, and wondered why this could not be expanded? TF explained about the licence condition trying to incentivise DNs to reconnect customers as soon as possible. A GDE would be different and required a different incentive – the problem might be due to the behaviour of upstream parties and the downstream parties are carrying the liabilities; there was concern that costs should be targeted at those who cause the problem.

JCx noted there were concerns voiced previously regarding cash out being frozen really low/too early, and concerns that DSR will not create a sufficiently enticing curve to encourage gas into the market. Volumes and prices that come through DSR may not be sufficient; it depends on the detail, and every day might be different. TF commented that the SCR proposes concepts. Domestic customers place a high value on secure supplies. At whatever level this is, incentives should be there to bring gas in up to that price. JCx questioned, how do you actually value that? Thirty pounds is probably a week's worth of gas – a figure that is almost meaningless, and certainly not enough to change anything from the consumer's perspective. CT noted that the London Economics work seemed to suggest electricity as an alternative, which would already be off? Referring to the London Economics work AM quoted £30 per day per one week outage (£210 per week). It is not in the Suppliers' gift to reconnect – it is in the DNs' gift. A cap might need to be considered for the duration of an outage. But it remains a concern that incentives need to be in place to deter NDM outages.

The freezing of cash out prices was discussed. CT believed there was no need to merge the two concepts. CW said that freezing the cash out price too low has absolutely nothing to do with compensating domestic customers; no market incentive is created.

TF referred to options previously discussed; the short Shipper target option had been dropped because of the increased risk for counterparties of a party continuing trading and then falling away. RF and CW believed a greater risk was associated with cash out.

Terminating a party for energy balancing debt may be different to any potential action that could be taken against a party in relation to compensation debt. TF considered that counterparties might not want to trade with parties that were carrying 'compensation' debt/insolvent for whatever reason. RF commented that the Energy Bill might address this, including some government safeguards whereby they could take control of suppliers.

A Compensation Fund

It was suggested that this could either be a standing or a reactive arrangement, set up in advance of, or following, a GDE. If a prior arrangement there was the certainty of payment (the fund being paid into over time and ring fenced for this purpose), but this would obviously be a standing/ongoing cost to the industry, and a possible barrier to entry. Conversely if a GDE occurred and a recovery fund was set up after the event to be contributed to ex post, how would payments be assured?

Who pays into the fund? Should it be an industry wide contribution, ie a collective responsibility (but all contributing parties may not be able to pass costs to customers). Should it be contributed to by Domestic Shippers only, ie collective responsibility and also likely to be passed onto customers? Or should it be left to individual Shippers?

How would costs be targeted? Would short Shippers' share of any fund be drawn down first, then other funds accessed? This could become very complex. The NEC will determine the extent of the Network isolation, and this may not necessarily involve those customers served by short Shippers,.

A disadvantage is that industry is paying upfront for what may be an arrangement that is never used – rather like an insurance policy – and would be accruing interest. There were other considerations related to cost of provision - what form should any contribution take, eg would it involve cash or Letter of Credit. If a fund were to be set up, eg escrow account, where should it be held and who would manage/have oversight of the fund. What percentage of customers would be covered by such a fund? How would this be administered before/after? How would a depleted fund be replenished?

RF commented that this would take monies out of the market that could be used or invested elsewhere. CW added that a Supplier Licence Condition could also have that indirect effect.

2.1.2 Centrica Presentation

CW gave a presentation and reiterated the background to the issue, noting that at its February SCR workshop Ofgem challenged the industry to develop a model for NDM compensation that might accompany cash-out reform proposals.

In considering the position Centrica believed that cash-out reform and NDM compensation are two separate issues and that linking the two causes more serious problems. In its view, it was essential to break the perceived link between compensation and cash-out.

Two models, very similar to those outlined by Energy UK in 2.1.1 above, were considered, with the majority of the discussion centring on the provision of a compensation fund.

A Central Compensation Fund

CW described a central fund to be set up in advance, outlined the advantages and disadvantages identified with such an arrangement, and how the fund might operate. He believed it to be no more of a barrier to entry than the SCR proposals, and that it was a sensible approach which, if taken on, would present further questions to consider such as, does any debt die with the Supplier and should the remainder be socialised?

JCx observed that consumers might well question why this money (assuming a large fund to be accumulated) was not spent on investment rather than compensation. The funds could be used to help avoid or to significantly reduce the effects of any such emergency, or to expedite and facilitate the speedy restoration of interrupted supplies to consumers. Perhaps the monies in any such accumulated fund would be better utilised for these prudent uses. Given the level of contributions contemplated over a number of years CW doubted whether the accumulated amount (£150m) would be large enough to consider use for many potential innovations, and went on to explain how the level of contributions had been calculated and might be collected.

Following an event that extended over a very large number of customers, there were concerns that there would be a shortage of appropriately trained operatives to effect a speedy reconnection to those affected. Dependent on the extent of any affected area, AR pointed out that DNs had labour sharing arrangements to assist in emergencies and other resources would be re-tasked (eg former field operatives) to carry out reconnections where possible. SC suggested that customers might be able to turn themselves back on; studies had been done indicating that in certain circumstances there was a far greater risk of fatality for a consumer through the effects of cold/hypothermia, etc, than in self reconnection.

JCx reiterated concerns that there were a number of groups throughout the industry that were discussing these and similar issues, but outcomes were not being disseminated and no one party appears to be taking a holistic view.

AM pointed out that this model did not include any incentives and address the need to avoid an emergency.

AR observed that the fund provided an ‘insurance policy’. CW pointed out that this addressed the compensation to NDM customers; any incentive could be completely divorced – no connection is necessary between the two elements, and they should be completely separate.

AM welcomed the discussion, but reiterated the need for industry to demonstrate that the incentives on both sides were as strong as Ofgem’s proposals. RF observed that those were viewed as too complex and were likely to grind to a halt. These are ways of separating out the domestic side and it will not really create a meaningful incentive.

CW then asked AM to clarify if it was Ofgem’s view that any proposal to compensate customers must be linked to cash out; consideration would therefore need to establish what the level of customer VOLL was. AC indicated consideration should be given to establishing the limit of the level of compensation that can be guaranteed to customers; reaching interruption on that level we may be taking unanticipated measures to hedge against the risk. RF observed that the size of any fund could never be ‘right’ because there were too many unknown factors.

Looking at the figures calculated there is the risk of over/under collection. These were based on average consumption, and that a GDE was more likely to occur in winter. Reconnection on any major scale was of concern, and it was always clear that continual review of prudent measures and operations to avoid reaching an emergency was good practice. In effect the fund would be there "not to be used'.

Applying a levy to the customer was discussed, and it was again questioned whether the fund monies should be left to accumulate or could be utilised to facilitate other prudent measures in the interim. CW had suggested capping the fund at £150m and periodically reassessing the risk and recalculating if further contributions would be required to reflect any as perceived/forecasted changes in the supply position. Periodic reconciling might prove too difficult to manage.

TD suggested that Xoserve could act as administrator/trustee and manage a fund. Assuming a fund existed and Xoserve had the management, MC said that if interim use of the funds for certain initiatives were acceptable then there would have to be some measure of certainty in the rapid ability to rebuild it should the need arise. There might be issues if the swiftness of the onset of an event meant it occurred before it was possible to recapitalise the fund.

CW questioned if a fund such as this was in fact underwriting each other's risks, if the fund paid out irrespective of the event/Shipper. Scenarios were discussed which could be addressed by having this 'collective insurance' approach. AR asked how a DN's reconnection costs might be recovered; would this be factored in? CW believed that to be outside the scope of this modification; perhaps another similar fund might be required, or perhaps the DNs should explore this concept with Ofgem.

Further questions raised by CW concerned how to take any action forward. Would this as a separate UNC modification facilitate any of the relevant objectives? Should it be incorporated within Modification 0435? Should it be prepared as a separate paper or report for Ofgem's information and consideration?

Asked if Ofgem would use Energy Act powers to drive change, AM indicated this would require consideration, as would any Licence changes.

TD asked for any further views on incentives.

A future increase in storage facilities may argue, following reassessment of risk, for a corresponding decrease in the fund.

RF said that E.ON was more likely to support money being spent on something such as an increase in flexibility rather than a compensation fund.

CW believed that a customer charge to contribute to the fund would be the most transparent.

AM was very mindful that the model does not cover incentives; what 'incentives' there were are not 'appropriate' and would most likely not be supported.

RF observed that Ofgem's proposals tied up more credit than this proposal.

AM commented that Shippers were unlikely to reassess risk if the compensation fund was there. CW commented that Ofgem might need to be careful if it thinks that risk is assessed and therefore everything is fine.

CW questioned, the 'incentives' are to do what? AM said, to avoid NDM interruptions through the cash out price, reflecting all balancing actions.

CW questioned if we were not going to invest, how would we do this?

CR asked Ofgem, was it acceptable to raise the modification to create the fund?

CW thanked everyone for their contributions to the discussions, but recognised that a consensus view on the best way to revise Modification 0435 was unlikely to materialise. RF said that he would like to see DSR progressed; customer compensation was a separate issue.

2.2 Option Analysis Table

This was revisited.

CW said that it seemed that a DECC standard was not going to be provided in the foreseeable future in order to establish a desired DSR volume, and asked whether the fact that Modification 0435 puts in place a framework was sufficient.

RF said that devising a clear methodology for calculating volumes might be sufficient. CW responded it was hard to define a methodology not knowing what you want to achieve. RF indicated that E.ON had attempted to calculate the gap with a methodology. CW indicated that he was reluctant to set a standard in the absence of DECC providing this; was it acceptable to have a European standard, with zero, as an outcome?

TD asked if a certain level of security of supply should be targeted – is that the purpose. JCx asked should we force it to run by setting a particular factor to elicit some price discovery and so begin to try and get a feeling for the market to enable some incremental improvement to take place.

RF said that E.ON came up with an approach based on an European standard and explained the factors assessed to the point where supply does not meet demand (relying solely on indigenous sources of supply). JCx described a further approach using other sources and a simple aggregation to try and build a volume requirement.

AM indicated that Ofgem is open to suggestions; any auction is primarily to deliver price discovery and not a security of supply standard; given the objective is a DSR bid stack, excluding the supply side is appropriate.

CW said that parameters to fix a volume are all floating so it is very hard to do this. Should we fix an exercise price? Or a budget for National Grid NTS?

DL believed that restrictions around option or exercise prices might open up opportunities for 'gaming'. However, with a budget NTS could contract when no service is needed, and therefore funds would be wasted.

TD questioned, is the budget the amount you would spend if it were called? This was discussed. AC suggested that a fixed option or exercise price could be set; the budget could be related to the option price, with the exercise price coming in to play through the cash out price. FS reiterated that monies should not be obtained for non-participation. AM said that being interrupted is a balancing action: it should not be a free option. However, those who participate in a DSR process should be better off than those who choose not to.

TD questioned the consumer's view and whether a consumer might feel disinclined to participate, especially with a zero option price. DL and CT thought consumers might be more encouraged by the prospect of tranches. TD reiterated that consumers would consider the costs of participating and balance this against any perceived benefit.

AM drew attention to an Ofgem Workshop planned for 11 March 2013, at which a proposal relating to DSR and auction design will be considered, drawing on consultants' experiences. This was likely to be different to Modification 0435 and may help the Workgroup to decide what to include/exclude under Modification 0435. Ofgem had given the consultants guidance on its position.

CW believed there was a great deal of merit in how Modification 0435 was currently formulated, but it would not deliver price discovery. JCx commented that it was trying to provide a buffer, to fill the gap if supply fails.

CW suggested that DECC should give a target security level; NTS would then confirm if that was needed and how far short we might be, and then that is what needs to be procured. We need to know if we meet a particular standard, eg European.

JCx noted that the European standard focuses on protecting customers, and that a year ago DECC had decided that everything was fine. A sensible order for taking off in an orderly fashion needs to be established. Ways to create a bid stack were then discussed and how to generate a level of positive customer engagement. It may be that a DSR is not necessary, and there would actually be less interest than was anticipated (rather be firm and have a high VOLL).

It was suggested that many customers would prefer an option fee – there would be no interest without, and no participation if just an exercise fee was offered. Various combinations were discussed. AC suggested that the option fee could form a discounted proportion of the transportation charge.

CW asked what would be a meaningful budget? TD said if the exercise fee was zero a large budget may be required; and the potential scale was discussed.

CW asked how this might work with cash out, believing the exercise fee has to be excluded from the initial budget. TD asked would it be a completely flexible exercise fee and be ranked on this?

AM confirmed that Ofgem had discussed the same issues with the consultants.

JCx believed that what a customer was offering as a service needed to be separated from any speculation as to how they might be planning to meet the provision of that service. AM suggested that a penalty regime would be in place to cover default (assuming circumstances admit of the service provider having had sufficient time to enact its plans to meet its obligation to fulfil the service contracted for). JCx said that customers offering such a service (turn down, restricting capacity take off) was a way of buying the time that was required to prevent a negative situation escalating into a GDE.

Looking at Item 7 on the Options Analysis table, JCx said that fixing the exercise price is not going to provide the required bid stack, ie it delivers nothing and does not meet the objective.

Looking at Item 8, TD observed that fixing the option price was potentially attractive but did not offer much encouragement for participation.

Looking at Item 9, TD commented that option fees could be seen as a cost of operating the system and should sit within that cost. FS noted it was an 'emergency' cost; OM is a commodity charge and has been called on twice in the last six years (during which time there have been more GBAs). Perhaps separate arrangements were required for funding as commodity charges are a disincentive that drives gas to other markets.

2.3 Next Steps

CW will revise the modification to reflect the position he feels it has reached in light of these discussions and following Ofgem's Workshop on 11 March 2013, with a view to bringing it to the next meeting on 04 April 2013 (see details at 4, below) for further consideration.

3. Any Other Business

None raised.

4. Diary Planning

The next Workgroup meeting will take place on Thursday 04 April 2013 at the Energy Networks Association (ENA), 6th Floor, Dean Bradley House, 52 Horseferry Road, London SW1P 2AF, and will be accommodated within the Transmission Workgroup.

Workgroup 0435 - Action Table

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	3.0	*Business Rules* - Consider what might be required for the development of an appropriate methodology for accepting offers.	National Grid NTS (DL)	Carried forward
0435 02/01	19/02/13	2.1	*NDM Customer Compensation* - Check details of payment timescales adhered to by the DNs for failure to supply gas (FSG).	All DNs	Pending