NDM Compensation in the event of involuntary interruption during a GDE

Ofgem's SCR proposals incorporate compensation for domestic customers that are interrupted during a GDE at domestic VOLL, with this being paid on the first day of any interruption and also being reflected in the cashout price. Industry has voiced concerns over the distortion to market prices this would lead to.

This note seeks to consider other options for NDM compensation that do not feed into cashout. The issues were discussed in a telecom with Energy UK members on 12th February and are to facilitate further discussion rather than reflecting a particular Energy UK position.

Two broad options were developed, with a number of variants

● A compensation fund

● Supplier Licence condition

A Compensation Fund

- Funded pre or post event
- Focussed on individual shippers, domestic shippers or industry wide
- Targeting to short shippers may be possible
- Fund would need to be protected in the event of supplier bankruptcy
- % of customers covered needs to be determined and VOLL
- Similar to pension payment protection arrangements
- Where is fund held? Who has oversight of it?

	Pros	Cons
Contributions to fund *ex ante*	Ensures money is there to pay customers	Adds cost to industry that are likely to be passed to customers May never be used May be a barrier to new entrants Customer number threshold like ECO? may mitigate this
Contributions to fund *ex post*	No upfront costs to industry / customers	Not clear that payments could be assured in the event of supplier insolvency
Industry wide	Collective responsibility	Creates costs that cannot be passed to customers Companies may not have any customers
Domestic suppliers collectively	Collective responsibility NEC determines which NDM customers interrupted not necessarily those supplied by short shippers	May never be used Prevents money being used to secure supplies
Domestic suppliers individually	May be administratively simpler than collective funds	May never be used Prevents money being used to secure supplies

Targeting withdrawal from fund to short shipper contributions which would then have to be replenished	Creates incentive to avoid interruptions but see cons	NEC determines which NDM customers interrupted not necessarily those supplied by short shippers Shippers that are short may have taken reasonable steps to secure supplies
Protecting fund – escrow account or letter of credit	Ensures money is available to pay customers who are interrupted. Ring fenced in the event of supplier bankruptcy	Cost of letter of credit May never be used Prevents money being used to secure supplies
Setting assumptions for level of fund	Could link to unserved energy from modelling	Arbitrary

Supplier Licence Condition

- Licence condition in domestic supply licence to pay NDM compensation in event of interruption
- Customers receive compensation rapidly – any targeting carried out later
- Capped at 1 day domestic VOLL
- Options – ring-fence to supplier, target to short shippers, other neutrality mechanism
- Less interventionist measure

	Pros	Cons
LC in domestic supply licence	No upfront cost to customers Simple to implement Market consequences avoided Payment to customer rapid since supplier has direct relationship with customer	Compensation not necessarily paid by those causing emergency – but that may be difficult to prove and subject to legal challenge
Capped at 1 day domestic VOLL	Consistent with SCR proposal Avoids risk of unlimited liabilities Restoration not influenced by shipper response	
Ring-fence to supplier	Responsibility and risk sits with supplier Simple to implement Minimal / no central systems impact	Customers may not receive compensation if supplier becomes insolvent (could consider socialising the residual) Choice of which NDM customers are interrupted sits with NEC not supplier so supplier pays even if not at fault but may receive cashout?
Target to short shippers, possibly with extended time	Principle seems right May prevent sudden shipper	Short position at the end of the day may not reflect cause of

period to recover money	insolvency	emergency Short shippers will face cashout Adds complexity Systems needed Credit issues May lead to slow decline of shipper as tariffs become uncompetitive
Other Neutrality mechanism?	Shared responsibility	Systems impact

Other Issues

Energy Bill consultation on how costs are managed and recovered if suppliers fail does not prescribe how or over what time period costs should be recovered – flexibility is retained. This model may be helpful

Level of NDM compensation – believe Ofgem is looking again at London Economics work and may come up with a value other than £20 therm. There could be some logic in setting it at the same level of compensation as for networks an absolute value £30 rather than volume related. This would link back to £5-8 therm at peak winter consumption levels. Alternatively different levels could be set for summer and winter.

Timing of payments to customers – customers should be paid soon after interruption occurs; cash payment or reduction on next bill? Latter may be cheaper and easier to administer and mitigate immediate cash flow impact on suppliers.

Whatever mechanism is put in place need to maintain the integrity of the NBP market and ensure the UK is still and attractive place to land gas.