Representation For. 0021

"Revision of the Emergency Cashout Arrangements"
Version 1.0

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Slant:	Against
Strictly Confidential:	No

Abstract

RWE npower welcomes the opportunity to comment on this modification proposal.

Whilst there are aspects of the modification which we support and recognise as being similar to proposals we have raised in relation to emergency cash out arrangements in electricity, RWE npower does not support the proposal. This is because we are still unclear exactly how the EIV methodology will be applied and are concerned that the wider impact of the modification proposal have not been properly understood or considered.

These concerns may have been assuaged had the modification proposal been developed and debated at an industry workstream rather than having been raised as urgent. To this extent it is regrettable that the very work group set up by Ofgem to consider and develop appropriate solutions regarding this issue did not have the opportunity to debate the proposal as currently presented.

Whilst supporting information has been issued and industry discussion has taken place during the consultation process we believe this is a poor substitute for proper debate and development in advance of the proposal being tabled. The fact that clarification regarding the legal text accompanying the proposal was issued the day before the consultation closes is symptomatic of the inadequate process adopted in relation to this modification proposal.

In our opinion the commercial, licence and public relations incentives on shippers to prevent a gas emergencies arising are already strong. Nevertheless we do believe it is appropriate to review whether these need to be strengthened further by changing the cash out arrangements that apply in the event the market were to fail, in light of the elimination of Top Up and the tightening supply/demand balance.

A dual emergency cash out price may strengthen the incentives on shippers to avoid an emergency situation arising to the extent they are able to take effective action that adjusts their balance position in the run up to an emergency. However in the event they are not (for example due to a catastrophic

failure of a beach terminal), or once in an emergency situation where they are required to comply with the directions of the NEC, dual cash out prices may significantly increase shipper exposure.

Once the OCM has been suspended therefore we believe it is appropriate to retain a neutral price (30 day average SAP) as the basis for settling imbalances. This is because the market based incentives of dual cash will not necessarily increase incentives on shipper to balance as they may not be able to take effective action to alter their balance position. To do otherwise could expose shippers to SMP buy for an indefinite and unpredictable period during an emergency event. In the event shippers are unable to effectively mitigate this exposure this could quickly lead to shipper failure.

With regard to the proposed introduction of EIV title trades (at 30 day average SAP) we support in principle what this is trying to achieve, namely that shippers whose short position may have contributed to the emergency being declared do not benefit financially as a result of emergency interruption by the SO. This may also lead shippers to interrupt sites or offer demand side response sooner than they might otherwise have done under the existing arrangements.

However, we are still unclear how the mechanism for calculating the EIV volume will work in practice, and are concerned that shippers would appear to have little transparency over the calculated volumes due to the fact there will be one EIV trade for their entire portfolio. Whilst we accept that the EIV trade can only ever be an approximation of the quantity of gas that would otherwise have been taken in the event a site is subject to emergency interruption we are unclear, for example, as to how Transco intend to calculate volumes for partial gas days where they do not have access to within day offtake information.

It is perhaps unreasonable to expect that in an emergency situation shippers should be provided with a detailed breakdown of the EIV calculation associated with their portfolio. However, it is not unreasonable for shippers to expect such information to be made available at a later date, and for that information to be subject to challenge. Similarly shippers should be able to clearly understand the methodology the SO will use to calculate the EIV for all sites that could be interrupted, such that they are able to model the impact the SO's actions may have during an emergency event.

We are also concerned that the process for notifying shipper interruption will become more complicated in order to cater for the possibility of the SO calling emergency interruption, and that there is a lack of clarity as to how the interruption notice period is treated should a site be subject to both shipper and emergency interruption simultaneously. Billing of EIV trades may also necessitate changes to invoice file formats and shippers reconciliation systems/processes which have not yet been assessed.

In the event this modification proposal is approved we believe it is important to reconsider the appropriateness of the emergency cash out arrangements in electricity bearing in mind the close interaction between the two markets. We would welcome the opportunity to participate in any discussions on this issue, and believe that there is considerable merit in a wider debate on how the SO role and balancing regime that currently exist in gas and electricity markets can enhance each other to prevent and mitigate the consequences of gas and electricity emergencies.

With regard to the specific issues raised in the draft modification report we would make the following comments.

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

Fixing the Emergency Cash Out Prices to dual prices set at the point of market suspension will provide a strong incentive on parties to avoid being short in the period prior to an emergency being called. However, since the market is effectively suspended during the emergency period, parties may have little or no ability to trade out imbalances or take effective action to rectify them. In addition the duration of an emergency event is uncertain and may affect more than one day. Consequently, parties that are short may be exposed to a high and unknown cost of imbalance, although this may be mitigated to some extent by the smearing of neutrality payments.

Further it should be noted that while the prices are fixed, the principal actions that Transco as system operator is taking during an emergency is to cut off firm loads (if it is assumed all interruptible loads have responded to the price signals). The cost of these actions in the period immediately prior to market suspension would implicitly be priced at the SMP buy price.

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

Exposure to the SMP buy for parties that are short during an emergency period is likely to be considerably more costly than exposure to 30-day average SAP. Therefore the financial risk shippers face in an emergency is expected to be greater under this proposal when compared with to current situation, and there may be a greater risk of shipper failure.

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?

The introduction of SMP buy during the emergency period provides a strong incentive on parties to avoid emergencies. However, this effect may be mitigated to some extent since the cost of the actions are reflected in neutrality payments, although a parties ability to anticipate any neutrality benefit is severely challenging.

Rather than reflecting the cost back through neutrality it may be more appropriate to reflect the cost in the relevant transporter's system operator incentive scheme.

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

It is important that a reasonable estimate is created based on returning a party to the imbalance that would have prevailed prior to the emergency period.
Transco's methodology, as currently understood, would appear to provide the basis for creating such an estimate. However, as stated above there is still considerable uncertainty how this will be applied for partial gas days, and how it interacts with shipper interruption. It is disappointing that further clarity was not provided in advance of this urgent modification proposal being raised or during the consultation process. We would hope that Transco expand on this further in their response.

Is a 30 day average SAP an appropriate "relevant price" for trading the emergency interruption?

The most important effect of the EIV title trade is the removal of the potential benefit resulting from a reduced exposure to SMP buy during an emergency as a consequence of actions by the system operator.

As noted above, the "implicit" price for the EIV volume in cashout is SMP buy. However the actual payment for the trade is in effect arbitrary. 30-day average SAP may provide an adequate recompense to parties for the average portfolio cost of gas purchased prior to an emergency. However, in periods approaching an emergency, parties may have paid closer to the marginal price of gas to balance their position.

The effect of neutrality payments could to some extent mitigate the benefit received for the title trade, although it is unlikely that any shipper will be able to anticipate this effect with sufficient certainty for it to influence its actions during an emergency.

It is also worth noting that if parties are all short in proportion to their metered volume then the effect of neutrality payments results in a zero net payment to parties.

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

The EIV calculation will be based on an estimate. As such there may be a risk of inaccuracy in the estimate or the calculation. The methodology required to derive the EIV should be open and transparent, and, if appropriate, should allow parties to challenge or mutually agree the volume calculation.

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

This question is obviously addressed to Transco and it is disappointing that it was not addressed in advance of the modification being raised or during the
consultation process itself, as we believe it may have allowed shippers to make a more informed response. This analysis would in particular help us to better understand the neutrality implication of the proposal compared with the current position.