

Representation For. 0042
"Revision of the Emergency Cash-out Price"
Version 1.0

Date of Communication: 22/08/2005
External Contact: (Powergen Uk Plc)
Slant: For
Strictly Confidential: No

Dear Tim

E.ON UK does not support Transco's modification proposal 044 and we consider that our proposal 042 better addresses the perceived issue that the current emergency cash-out price does not provide the most appropriate incentives on Users to make suitable provision to avoid entering into a Gas Deficit Emergency (GDE) and therefore better facilitates the following relevant objectives:

1. (e) the provision of reasonable and economic incentives for relevant suppliers to secure that the domestic customer supply security standards are satisfied as respects the availability of gas to their domestic consumers, through ensuring the appropriate arrangements are in place to incentive shippers / suppliers, where they have the time and information to react to market signals, to avoid entering into a Gas Deficit Emergency (GDE) and thus minimising the probability of threatening domestic customer supply security.

1. (d) (i) the securing of effective competition between relevant shippers and (ii) suppliers, through targeting cost during an emergency thereby encouraging Users to take appropriate actions to avoid a GDE. Such actions might promote greater and more effective competition between shippers and suppliers.

Cash-out

Setting the emergency cash-out price at the prevailing SAP strikes the appropriate balance between a neutral cash-out price and a penal emergency cash-out price of SMP Buy, for Users which are short of gas. Where an emergency is progressive, the SAP will be appropriately high to provide additional incentive on Users to avoid entering into a GDE. Where the emergency is rapid, such as a terminal failure, Users do not have sufficient time to respond to avoid an emergency, the SAP is a more appropriate price than SMP Buy as Users should not be hit with a penal Buy Price for something which they have been unable to avoid.

With regards to the stated issue that Users may not be appropriately incentivised to sell gas in an emergency, it is worth pointing out that if any User feels that they have suffered financial loss by reason of being paid only the relevant cash-out price for gas delivered to the System, a User can submit a claim to Transco to be paid at a higher price.

Arguments made in response to Transco's original proposal that SMP Buy Price could be set inappropriately high, as the result of small volumes of gas offered at a high price, still stand. As Transco have stated in their proposal, Transco may take a small quantity, high price action if, in aggregate, the small quantities aid the overall supply / demand balance. In Ofgem's decision letter to reject the electricity modification proposal P135: Marginal System Buy Price During Periods of Demand

Reduction, Ofgem stated that they were ‘concerned that marginal Energy Imbalance Prices could potentially be distortionary as they could be set based on a very small volume of energy accepted by the SO or alternatively based on System Balancing action.’ The letter goes on to state that ‘Ofgem was also concerned, in light of experience in the gas market, that a marginal cash-out regime could increase the risk of manipulation to drive up Energy Imbalance Prices and market prices to levels that would not reflect underlying market fundamentals’. We agree with Ofgem’s comments made in their decision letter to reject a marginal cash-out price in electricity during demand reduction and we would have serious concerns if this was not felt to be a substantial enough issue in the gas market to be reason to reject Transco’s proposal.

Modification proposal 042 ensures that Users are not exposed to extremes and the unmanageable risk created by an SMP Buy price, but at the same time, suitably incentivises Users to take action to prevent a GDE from occurring.

Emergency Curtailment

Whilst we accept the principle which this element of the proposal is trying to achieve, we can not support implementation of this element of the proposal, ahead of this winter. We accept arguments that this winter may be tight and the appropriate arrangements need to be in place to avoid a GDE, however, the uncertainty that this element of the proposal creates, would, in our opinion, put further strain on the market and may actually prolong the duration of an emergency. Moreover we remain concerned that the ECQ calculation sits outside of the Code and different methodologies could be used by different Distribution Network Owners, further increasing uncertainty and fragmentation ahead of this winter.

More detailed analysis is needed to reflect, for example, comments made at the Transmission Workstream on how an influx of P70 forms in an emergency could actually deflect focus away from the necessary actions to resolve that emergency.

When the market is effectively broken, physical, not commercial response ought to be the primary focus.

Process

Whilst we acknowledge Transco’s effort to bring their proposal to the Transmission Workstream, we remain very concerned with timescales and process. Users only had one day to analyse the proposal before it was discussed at the workstream. Usual process when receiving a proposal would be to circulate it to key areas of the business so the pros and cons of any proposal can be fully assessed. Raising a modification within such tight deadlines, in the holiday period does not allow for such thorough analysis, desperately needed for such a proposal. We share the Authority’s serious concerns with respect to the material deficiencies in the process of urgent modification proposals, noted in their decision to reject modification proposal 021, and consider these concerns remain in the process undertaken with this proposal. There is simply no time, particularly in relation to the ECQ element of the proposal to address all the relevant issues and affects of the proposal. The ECQ element in particular is in need of being tested through an emergency scenario to fully ensure that the proposal does in fact do what it proposes to do and does not deflect focus, though overly complex rules and paper bureaucracy away from a physical response to avert an emergency.

We note Transco's point raised in their proposal that any proposal brought forward to develop an aggregated or de minimis marginal price would require significant development and discussion within the industry. With this in mind, we fail to see why Transco feel their proposal, with very complex and lengthy mechanisms for dealing with Emergency Curtailment, does not warrant the same significant development and discussion.

We also note that no urgent review of Transco's and the Joint Office's processes, as considered by Ofgem as necessary in their decision for Modification Proposal 021, has, as yet, commenced to ensure that the material deficiencies, as stated earlier, do not occur in the future.

In conclusion, we support the implementation of modification proposal 042 for the reasons set out above and as stated in the proposal. We do not support modification proposal 044 as we believe the emergency cash-out element is unduly penal and is open to perverse incentives and the ECQ element is in need of wider industry discussion and understanding.

Please do not hesitate to contact me if you wish to discuss any of the above.

Yours sincerely

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