RWE npower

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Modification Proposal 260: Revision of the Post-emergency Claims Arrangements

Dear John,

RWE npower welcomes the opportunity to comment on the above Proposal and does so on behalf of all its licensed gas businesses and its sister company RWE Supply and Trading GmbH.

Implementation of Modification Proposal 044, which we offered qualified support for, placed very strong commercial incentives on shippers to take appropriate demand and supply side actions to balance their portfolios during times of high demand and system stress. In our opinion it represented a proportionate measure for ensuring that shippers fulfil their primary balancing role and do everything they reasonably can to avoid gas supply emergencies occurring.

However despite the introduction of these measures the possibility of a gas supply emergency occurring, whilst remote, can not be completely ruled out. Because of this we believe it is crucial that all gas market participants have a detailed and unambiguous understanding of the statutory, licence and UNC obligations that apply in an emergency.

National Grid NTS regard this Proposal as an incremental step to enhance the existing commercial framework. By bringing greater clarity and definition to the UNC post-emergency claims arrangements they believe additional non-UKCS supply and/or demand side response will be encouraged. Whilst this could be true we firmly believe[1] that the security of GB's gas supply, and the safety of its transportation network, would be best served by National Grid NTS purchasing any additional non UKCS gas that may be made available in conjunction with its firm load shedding activity, under the direction of the NEC.

Such change is not within our gift as it cannot simply be achieved by way of a UNC Modification Proposal. We sincerely hope however, that it be considered in any wider HM Government initiated review of the UK Security of gas supply arrangements which is alluded to in page 3 of the Proposal.

To the extent that the Proposal could encourage additional non UKCS supplies to the GB market during an emergency, by providing greater certainty that any such gas delivered will be paid for at a price which properly reflects the suppliers prevailing opportunity cost, we are prepared to support it. However as it is not possible to gauge the extent to which the Proposal will deliver more additional non UKCS gas

[1] As previously set out in our response to Modification Proposal 149/149A dated 26/6/07 available at http://www.gasgovernance.com/NR/rdonlyres/9D819D6A-227B-4733-80C6-A59AE7CBAD5E/18018/01490149ARWE.pdf

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vis a vis the existing arrangements and as have a number of other concerns about the Proposal, we do so on a qualified basis and somewhat reservedly.

We trust that National Grid NTS and the Authority will give due consideration to these concerns and consider ways to address them should the Proposal be implemented. As the Proposal represents an incremental step in what are already comprehensive gas emergency arrangements and, as National Grid NTS admit, may only attract additional gas supplies on the margins of the quantities required to alleviate a Gas Deficit Emergency, it is a finely balanced argument as to whether the Proposal meets the relevant objectives of the UNC. As such we believe the Proposal should be considered within a wider context of how it affects the ability of all gas market participants to comply with their obligations in an emergency.

We disagree with National Grid NTS's assertion that the Proposal will encourage additional demand side response. The ECQ trades arising from Modification Proposal 044 already create strong incentives for shippers to contract for interruption with end users and should ensure that all large firm load that is price sensitive and readily able to provide demand side response is taken off the system before a Stage 2 gas supply emergency is declared. To the extent that any large firm load remains on the system after this, it will need to arrange through its shipper to post a demand side offer on the OCM[2] before receiving a Stage 3 emergency interruption notice in order to receive any financial recompense. It is naive to think that this can be done within the contact times indicated in the T/P/M/E/1 Procedure for Network Gas Supply Emergency document, particularly outside office hours and in the climate of climate of fear and panic that is likely to be prevailing at the time.

Other reservations we have about the Proposal, and its ability to further the relevant objectives of the UNC, are as follows.

<u>Complexity</u>

Bearing in mind the infrequency with which National Grid NTS accept Physical/Locational Market Offers in their residual balancing role we have some concerns about how effective the Proposal will be in acting as a "potential emergency claims bulletin board" bearing in mind it is heavily reliance on shippers posting such offers. We welcome the fact that National Grid NTS intend to hold familiarisation workshops to remind shippers how such offers are posted on Gemini. We would stress however that such workshops need to extend beyond the mechanics of posting offers and to clearly explain the inter relationship between any OCM Physical/Locational Market Offers and their prevailing Physical Input Nominations.

Following declaration of Stage 2 of a gas supply emergency all shippers are required to maximise beach supplies and reflect this, along with any non UKCS gas being delivered under contract, in their Input Nominations. To the extent a shipper can access additional non UKCS gas, and decides to deliver this to GB in such a way as to allow it to register a post emergency claim (should no shipper accept the price it is prepared to sell it for), it posts a Physical/Locational Market Offer on the OCM and at the same time increases its Input Nomination at the System Entry Point where it is being delivered. Should the OCM offer be accepted by another shipper it will then have to make an OCM Contract Renomination increasing flow at the relevant SEP (because the OCM market rules require this) despite the fact that that no extra gas is being delivered to the System at this point. Consequently it will then need to reduce its Input Nomination by an equivalent amount such that it is still providing an accurate picture of the gas it is delivering to the System.

Under normal market conditions shippers do not typically increase their Input Nominations when posting Physical/Locational Market Offers or make Input Nomination reductions offsetting OCM Contract Renominations, as gas is normally only delivered to the System once a Physical/Locational Market Offer is accepted. Should shippers inadvertently fail to increase/decrease their Input Nominations National

[2] to the extent it can meet the minimum Market Offer Specified Quantity of 100,000 kWh

Grid NTS, and the NEC, could receive a false picture of shippers physical gas flows. We are concerned about the implications of any potential confusion surrounding shippers physical gas flows which, in extremis, could lead to a diminution in the NEC's ability to maintain System integrity.

<u>Shipper Uncertainty</u>

The Proposal makes the bold assumption that once an emergency has been declared shippers will have a clear understanding of their imbalance position, such that long shippers can post Physical/Locational Market Offers on the OCM[3] thus enabling them to achieve a defined price or to register an emergency claim to be paid that price. Similarly short shippers can purchase gas on the OCM[4] to mitigate their exposure to cash out prices or the neutrality smear resulting from any accepted post emergency claims.

However in an emergency situation we doubt shippers will have full clarity of their imbalance positions and as such they may lack the necessary confidence to commit to any transactions which help their imbalance position, particularly high value transactions. In the climate of climate of fear and panic that is likely to be prevailing in an emergency shippers may take the view that the safest option is to do nothing, particularly when the consequences of trading based on inaccurate imbalance information could be to make their commercial position materially worse than it already appears.

There are a number of reasons why we think shippers are unlikely to be certain of their imbalance positions in an emergency. For example in maximising their beach supplies shippers may be reliant on the "reasonable endeavours" of its supplier and so will not be sure whether additional gas will actually be delivered or not. Shippers may also be unsure of what gas is being delivered at an entry point which is subject to a constraint (which may have triggered the emergency), or the accuracy of their NDM Output Nominations once public appeals to reduce gas consumption are being made.

However we believe that the biggest reason shippers may be uncertain of their imbalance positions in an emergency will because of firm load shedding of large non VLDMC load. Once an emergency has been declared transporters will contact such load directly instructing it to commence Emergency Curtailment. Whilst the T/P/M/1/E document states that the primary transporter will communicate with affected shippers informing them that their sites have been instructed to cease taking gas it is by no means clear how quickly shippers will be informed of this, or whether such communication will confirm that cessation has actually occurred and from when. Whilst shippers can anticipate which sites will be subject to firm load shedding the first real indication of the extent of this will be seen when National Grid NTS issues an ECQ trade for the load that did not commercially interrupt prior to Stage 2 being declared.

ECQ trades are supposed to reflect the aggregate quantities of gas which each transporter reasonably estimates would have been offtaken but for the fact that emergency interruption has taken place. However it is not clear at what point in time following the declaration of an emergency the first ECQ trade will be issued or how frequently they will be updated thereafter. It is also highly unlikely that shippers will be able to equate any forecast of what their Emergency Curtailment Quantity should be with the quantity in the ECQ Trade, particularly as ECQ trades are at aggregate level across all transporters and all networks.

Shippers will not receive disaggregated Emergency Curtailment Quantity information until after the gas day (in the worst case by 20:00 D+4) and bearing in mind the complexity of the ECQ Methodology and the potential financial materiality of ECQ trades, the likelihood of this being subject to challenge is high. However, as the process for challenging the Emergency Curtailment Quantity extends beyond the timescale for submitting a post emergency claim shippers will have to base their view of their imbalance position on the Emergency Curtailment Quantity notified by National Grid NTS in the ECQ trade,

[3] Alternatively long shippers can sell their gas at the NBP via the OTC or OCM markets.
[4] Or OTC market

regardless of whether they think this is correct or whether it is subsequently adjusted.

To the best of our knowledge the ECQ trade arrangements have never been tested as part of National Grid NTS's annual emergency exercise and we believe they should be incorporated in this exercise at the earliest opportunity. Until such time as they are however, we believe it is a huge leap of faith for National Grid NTS to assume that shippers will be in a position to post their long positions on the OCM so as to entitle them to make a post emergency claim. The current claims process, whilst somewhat vague in its application, would at least afford shippers the opportunity to register a post emergency claim once they know exactly what their long position is, rather than expecting them to have to base their claim on an imbalance position whose accuracy they may be unsure of.

Neutrality Process

In a perfect world exposing short shippers to the cost of any claims that have passed the post emergency claims review process should create an incentive for them to accept Physical/Locational Market Offers whilst an emergency is in operation if the price associated with such offers is less than, or even greater than, the frozen cash out price. Leaving aside whether it is appropriate in all circumstances to target short shippers in this way[5] there are a number of reasons why short shippers may be unwilling or unable to respond to such an incentive. The Proposal's loosely worded claims that this incentive might somehow improve the efficient operation of the System during an emergency, or result in a more timely restoration of normal commercial arrangements, are therefore highly questionable.

Firstly, a Physical Market Offer may not be capable of partial acceptance and the quantity may be greater than the size of a short shipper's expected imbalance position. Even if this were not the case a short shipper may be unable to provide the security required by the Trading System Operator to allow it to accept such an offer, particularly as this could be at a very high price. A short shipper could also take the view that there is a reasonable chance a Physical/Locational Market Offer will fail to pass the post emergency claims review process, in which case it may be advantageous to await the outcome of the claims process. Also there are obvious cashflow benefits arising from being exposed to a neutrality smear compared to accepting a Physical/Locational Market Offer. Finally, the indicative OCM volume weighted average price of all Physical Market Offers provided by APX during the emergency may not fully reflect the cost of the neutrality smear if it is inflated by Physical Market Offers that have specified rates[6].

Initial Comments on Draft Legal Text

Section Q.4.5.6 - Suggest replacing "in respect of" in the third line with "to effect"

Section Q.4.5.7 - Bearing in mind shipper exit quantities do not close out until D+5 and that disaggregated ECQ trade quantities for each site may not be available until 20:00 D+4 we think there may be occasions where shippers find it difficult to submit their Post Emergency Claims by D+6. Rather than extend this date we believe it would be more appropriate to change the "will" in the last line of this Section to "may". This provide shippers with some comfort that they will still be able to submit claims shortly after the Post-Emergency Close Out Date if there is a reasonable justification for this e.g. National Grid NTS submit an ECQ trade quantity which is obviously erroneous.

Section Q.4.5.8 (d) – Suggest replacing "an ECQ notice" with "Emergency Curtailment"

[5] Should post emergency claims neutrality smearing ever happen we would expect any perceived unfairness or discrimination to be addressed by way of an urgent UNC Modification Proposal, emergency legislation or litigation.

[6] Physical Market Offers with specified quantities will not be delivered to the System unless they are accepted and so will not be subject to the post emergency claims review process, despite being included in the indicative volume weighted average price calculated by the Trading System Operator.

Section Q.4.5.14 – The suggested legal drafting fails to reflect the specific level of detail included in Business Rule 3.19 and Appendix 5. It is not clear to us whether this is an oversight or whether it is intended to provide the Authority complete discretion over how failed post emergency claims are to be treated.

Section Q.4.5.15 – The suggested legal drafting fails to take of account of System Average Price as stated in Business Rule 4.3

Yours sincerely,

Steve Rose*
Economic Regulation

* sent by e-mail therefore not signed