

Shippers, National Grid Transco and  
other interested parties

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Dear Colleague

### **Network code modification 0702 “Partial ‘Volume’ Interruption”**

Ofgem<sup>1</sup> has carefully considered the issues raised in modification proposal 0702 to Transco’s network code, “Partial ‘Volume’ Interruption”.

Having had regard to the principal objective and statutory duties of the Authority, Ofgem has decided to direct Transco to implement modification proposal 0702 because Ofgem considers that the proposal will better facilitate the relevant objectives of Transco’s network code under standard condition 9 of Transco’s Gas Transporters (GT) licence.

In this letter, Ofgem explains the background to the modification proposal and gives reasons for making its decision.

### **Background to the proposal**

#### *Exit capacity regime*

Transco currently manages network constraints under the existing exit capacity, interruption and Liquefied Natural Gas (LNG) arrangements mainly by interrupting gas supply to customers with interruptible transportation agreements. Transco may call an interruption in the event of network capacity constraints, high system demand<sup>2</sup>, in an emergency or for testing purposes.

In terms of Transco interruptions, Transco distinguishes between Standard Interruptible (SNI) and Transco Nominated Interruptible (TNI) supply points. An SNI allows Transco to interrupt the site for up to 45 days each year. A TNI allows Transco to interrupt for more than 45 days each year. In addition, Transco may unilaterally designate an interruptible point (either a SNI or a TNI) as a Network Sensitive Load (NSL). Such loads, by virtue of their location, are more likely to be interrupted. Interruptible customers receive relief from NTS exit capacity charges.

#### *Existing partial interruption service*

The current arrangements provide shippers with the ability to nominate their interruptible supply points for partial interruption rather than a complete cessation of flows. In order to use this service, shippers effectively elect to subdivide their maximum daily offtake quantities into

tranches. As part of the interruption process, Transco will identify which tranches are interrupted. The uninterrupted tranches define the maximum hourly offtake following the commencement of the period of interruption.

The partial interruptible service is only made available at sites where metering equipment is available to assess performance against the service. The current arrangements allow Transco to charge shippers in the event that they fail to interrupt or meet the nominated hourly flow rate reduction.

*Modification proposal 0657 “Partial Volume Interruption Service”*

Network code modification proposal 0657, raised by Transco, sought to extend the present partial interruption arrangements so that supply points would be permitted to offtake at rates higher than those available under the present partial interruption service. In particular, it proposed that Transco would be granted the discretion to offer partial volume interruption (as opposed to partial rate interruption) services to shippers, whereby a partial interruption supply point is made subject to a daily offtake quantity limit rather than an hourly limit on flows. This would allow supply points to vary their gas offtakes throughout the period in which they have been partially interrupted subject to a supply point maximum hourly rate as specified in the relevant interruption notice. However this service would have only been made available when system flexibility permitted.

Ofgem rejected this proposal on the basis on a number of points:

- ◆ It could create the potential for discrimination between different classes of customers as the allocation of within-day flexibility for free to some shippers may lead to costs being imposed upon other shippers and, potentially, customers. Transco was unable to provide Ofgem with any assurances that this partial volume interruption service would not impose costs upon customers;
- ◆ Transco failed to publish any criteria or systems information for establishing how it would allocate the proposed services to shippers. In particular, Ofgem considered that the lack of transparency would make it difficult to assess whether Transco would be unduly discriminating between interruptible customers; and
- ◆ Ofgem further rejected this proposal because it proposed changing interruptible arrangements during the winter period, without a strong case being made regarding the importance of this service.

Subsequently, the following modifications have been proposed on the subject of interruption rights and are currently being progressed via the modification process.

*Network code modification proposal 0699 “Amendment to Transco’s Interruption rights for Supply/Demand Purposes”*

Network code modification proposal 0699 was raised by Shell to ensure that Transco has appropriate incentives to use market mechanisms and to provide market signals to suppliers and consumers about the value of flexibility in times of high demand. This proposal seeks to amend the current trigger that allows Transco to use its interruptible contracts for demand supply balancing. This trigger is currently met when forecast daily system demand exceeds 85% of Transco’s forecast 1 in 20 peak day demand. The proposal seeks to increase the trigger

to 95% over two years. Currently this modification proposal is still at the workstream development phase.

*Network code modification proposal 0705 “Changing the Basis for Triggering Supply and Demand Interruption”*

Network code modification proposal 0705, raised by Transco, seeks to amend Transco's supply/demand interruption rights set out in Network Code Section G6.7.3(c). It proposes to replace the reference to Forecast Total System Demand with an ability to initiate such interruption where, on any day, Transco determines that there is an Operational Balancing Requirement, which cannot be satisfied by a Market Balancing Action which will meet the requirement. Transco would then have the ability to utilise such rights prior to entering a Gas Supply Emergency (GSE). This modification proposal would remove the existing 85% supply and demand trigger, however if there were no bids or insufficient offers Transco would retain the right to interrupt sites. This proposal is currently with Ofgem for a decision.

*Winter Operation Report winter 2004/05*

Transco's Winter Outlook Report for winter 2004/5 published on 20 October identified a tightening of the supply and demand position for the coming winter due in part to a decline in the UK Continental Shelf (UKCS) gas supplies. The report identified that the market would need to deliver a quantity of demand side response which includes the total daily demand of the interruptible market sector if the security of supply in 2004/05 is to be maintained for severe (i.e. 1 in 50) weather conditions.

### **The modification proposal**

Modification proposal 0702 seeks to enhance the current partial interruption arrangements such that supply points requested by Transco to partially interrupt for supply and demand management purposes would be able to continue to offtake gas at up to their maximum supply point offtake rate for a limited period or periods, subject to defined volume restrictions, rather than being limited to the current hourly flat rate reduction.

The modification proposal would introduce a cumulative volume restriction that applies at each hour of the interruption period. At the end of any hour within the interruption period, the cumulative quantity of gas offtaken from the interruption start time to the end of that hour will be limited to the implied maximum volume of gas that could have been offtaken under the prevailing partial “rate restricted” interruption arrangements from the interruption start time to the end of the relevant hour. The service will apply at all interruptible supply points that successfully register but exclude NSLs.

### **Respondents' views**

There were seven responses to this proposal, two of the respondents fully supported the proposal, four offered qualified support and one respondent did not support this proposal.

One of the respondents fully supporting the modification proposal stated that the service should be applied in a fair and equitable way across interruptible sites. It also noted that communication between the interruptible site and Transco should be clear and unambiguous. One respondent supporting this proposal stated that if this proposal were to be implemented, it would be appropriate to do so in adequate time before this winter.

The majority of respondents offering qualified support and the respondents offering full support stated that in principle they were generally supportive of a modification proposal that offered more flexibility of operation to interruptible sites. Some of the respondents considered that the proposal would allow some interruptible customers to have greater flexibility in managing their gas usage. This would be especially beneficial for Combined Cycle Gas Turbines (CCGTs), allowing them to continue generating over the electricity peak demand hours.

Several respondents considered that the imbalance between supply and demand should be dealt with via market mechanisms and that Transco should not call interruption for supply and demand reasons or at least until gas available on the OCM has been utilised. These respondents stated that interruption should be a transportation constraint management tool and that Transco should be unable to use it as a free tool for supply and demand residual balancing. With this in mind the respondents wanted to view Transco's revised System Management Principles Statement, which would ensure that Transco would use the OCM prior to using interruption.

A number of respondents, including those that offered qualified support and those who supported the proposal, commented that they did not understand why NSL should be excluded from this partial interruption service. These respondents stated that at present NSL can apply for partial interruption and that exclusion from this proposed service could be deemed discriminatory. One respondent stated that if modification proposal 0705 was accepted by Ofgem, interruption could be called at lower demand levels and therefore NSLs should not be excluded. Another respondent stated that Transco, in its modification proposal, considered that NSLs would already have been interrupted for transport constraints. However this respondent did not consider that to be the case and requested further justification from Transco for its proposed treatment of NSLs.

One respondent noted that they had difficulty in following how this partial interruption service would work in practice. The respondent was not clear when there was an interruption whereby Transco had only given the minimum five hour notice, how in this instance the interruptible site could take advantage of this service. The respondent stated that it was unsure whether, for example, the linepack filling would start at the time the interruption notice has been received or whether it is from the interruption start time. Another respondent considered that not all partially interruptible sites would have sufficient flexibility to manage their gas usage in the way suggested by this modification proposal. The respondent considers that the arrangements are vague in that it is unclear whether these interruptible sites with less flexibility could continue offtaking gas under the current partial interruption arrangements, or whether these changes apply to interruptible sites that are new in registering for partial volume interruption. This respondent requested some clarity from Transco on this issue.

Most of the respondents stated that, in making a decision on this modification proposal, Ofgem needs to consider it alongside modification proposal 0705 "Changing the Basis for Triggering Supply/Demand Interruption". One respondent considered that if modification 0705 was approved it would render this partial interruption modification proposal largely superfluous, whereas another respondent considered that acceptance of 0705 would ensure that the partially interruptible regime would be used more frequently.

The respondent against the proposal stated that offering this additional flexibility could distort the value of firm load, interruptible exit capacity as well as the value of peak load in the electricity market. The respondent also considered that this proposal could cause generators to arbitrage

between the cost of failure to interrupt and the prevailing prices in the electricity balancing market. It also considered that NGT could indirectly benefit under the electricity SO incentives as a result of this modification proposal.

### **Transco's view**

Transco considers that this modification proposal would help to improve security of supply in the electricity market by enhancing CCGTs ability to satisfy peak electricity demand. Transco considers that the proposed service would allow greater access to system flexibility when such flexibility is available thereby providing end users with greater flexibility to manage interruption obligations in the context of managing supply point and alternative energy requirements. This proposal ensures that there would be no net depletion of linepack within the day and therefore no increase in the potential for system balancing actions. Transco stated that this was consistent with the safe, efficient and economic operation of the gas pipeline system.

Transco responded to the issue raised by several respondents regarding NSLs. Transco originally exempted them from this proposal because it considered that this level of interruption would only be used on days of very high demand and therefore it would be likely that the NSLs would already be responding to a transportation constraint. However, in light of respondents' views Transco has decided to extend this service to the NSLs when they are not required for transportation constraint related interruption.

Transco's response on the issue as to whether a partially interruptible site could continue with offtaking gas under the current arrangements was that these sites could continue offtaking the current hourly flat rate reduction if desired. Transco also responded to another respondent stating that the partial volume interruption applies to the interruption start time and not from when the notice is issued. Transco further responded to the scenario when the site may only be given five hours notice stating that this issue was never raised at the workstream or in other respondents' representations and therefore Transco considers that this service would be utilised by those who consider the commercial advantages outweigh the operational changes necessary to take advantage of them.

### **Ofgem's view**

Ofgem has carefully considered the views of all the respondents and Transco on this modification proposal. Having had regard to its principal objective, Ofgem considers that this modification proposal does better facilitate achievement of relevant objective (a) of Transco's network code.

*Relevant objective 9(a) of the GT licence – the efficient and economic operation by the licensee of its pipe-line system*

Modification proposal 0702 would allow the continuation of the partial interruption regime whilst still allowing customers to offtake the maximum amount of gas in some tranches if it has offtaken no gas in the previous tranches. Therefore, the modification proposal could allow end-users who previously could not be partially interruptible customers because they could not run at 50% of their offtake to register for this partial volume rate restriction service. These end-users could benefit from the additional flexibility that this modification proposal seeks to provide by being able to offer a partial interruption service whilst still being able to offtake gas to meet their peak demand. Therefore allowing this added volume flexibility would extend the partial

interruption service to end-users who previously could not register for the partial interruptible service.

Ofgem considers that this should lead to greater competition in the provision of these services, which could enable Transco to procure its partial interruption requirements more efficiently and economically. Therefore, Ofgem considers that this modification proposal better facilitates achievement of relevant objective 9(a) of Transco's network code.

#### *Other considerations*

##### *Operation of the new arrangements*

In its rejection letter for modification proposal 0657 "Partial 'Volume' Interruption", Ofgem stated that the modification proposal could discriminate against different users. Although modification proposal 0702 has addressed a number of Ofgem's concerns and reduced the amount of discretion available to Transco in determining whether to offer the service, it has not eliminated all of them. Under section 9(2) of the Gas Act 1986, Transco has an obligation to avoid any undue preference or undue discrimination. Transco must therefore ensure that it operates this partial volume interruption service in a non-discriminatory manner. In addition, Ofgem would expect Transco's procurement and use of interruption services to be transparent. Ofgem will monitor both these aspects of the new arrangements.

##### *Security of supply*

Ofgem notes the views of several respondents regarding the security of supply implications of this modification proposal on both the gas and electricity systems. Ofgem agrees that this modification proposal could have positive security of supply implications in that it may allow interruptible gas-fired power stations to continue to run during periods of peak electricity demand, whilst reducing gas demand through interruption for the remainder of the day.

##### *Failure to interrupt charges*

Ofgem notes the comments made by some respondents about the risk associated with arbitrage by electricity generators between electricity prices and failure to interrupt charges. In deciding whether to direct the modification, Ofgem must assess whether the proposal would, compared with the current arrangements, better facilitate the relevant objectives. As the proposal does not change the failure to interrupt charges, Ofgem is satisfied that the proposal passes this test for the reasons outlined above. However, Ofgem would note that it is concerned that the failure to interrupt charges may not be cost reflective and may need to be reviewed. Broadly speaking, for the first incidence of a failure to interrupt, the site is charged two times the applicable annual rate of the NTS exit capacity charge in respect of an NTS supply point. For subsequent failures, the charge is two times the relevant volume times the oil price minus the gas price from the figures published in the DTI Energy Trends table for the 1st quarter of the current gas year. If a site fails to interrupt, Transco is likely to have to take other balancing actions as a result. As they will be taken at short notice the costs of these actions are likely to be high and are unlikely to be related to capacity prices at that location. The failure to interrupt charges should therefore reflect the costs that Transco incurs in taking further actions when a site has failed to interrupt.

*Associated modification proposals*

Ofgem has considered respondents' views regarding the linkages between this modification proposal and modification proposal 0705 "Changing the Basis for Triggering Supply and Demand Interruption". Although the issues raised by the two modifications are clearly linked, Ofgem does not consider that they are contingent upon each other. Therefore, a decision on modification proposal 0705 will be issued separately in due course.

**Ofgem's decision**

For the reasons outlined above, Ofgem has decided to direct Transco to implement network code modification proposal 0702 because it considers that it better facilitates achievement of the relevant objectives (a) as outlined under standard condition 9 of Transco's GT licence and is consistent with the principal objective and statutory duties of the Authority.

If you have any further queries in relation to the issues raised in this letter, please feel free to contact Simon Bradbury on 020 7901 7249 or Fiona Lewis on 020 7901 7436.

Yours sincerely

**Steve Smith**  
**Managing Director, Markets**

<sup>1</sup>Ofgem is the Office of the Gas and Electricity Markets Authority. The terms 'Ofgem' and the 'Authority' are used interchangeably in this letter.

<sup>2</sup>Transco can call an interruption for supply/demand balancing purposes when forecast national demand is greater than 85% of the forecast peak day demand.