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Our Ref: Net/Cod/Mod/658
Direct Dial: 020 7901 7021
Email: kyran.hanks@ofgem.gov.uk

Shippers, Transco and Other interested parties

01 December 2003

Dear Colleague,

Network code modification proposal 0658 'Interruption Transfer Service'

Ofgem has carefully considered the issues raised in network code modification proposal 0658 'Interruption Transfer Service'. Ofgem has decided to direct Transco not to implement modification proposal 0658 because we do not believe that this proposal would better facilitate the relevant objectives of Transco's network code under amended standard condition 9 of Transco's Gas Transporters (GT) licence.

In this letter, we explain the background to the modification proposal and give reasons for making our 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 interruption in the event of network capacity constraints, high system demand¹, in an emergency or for testing purposes.

Interruptible transportation arrangements can be included in contracts between shippers and their customers. Typically, such contracts provide both for some level of shipper interruption ('commercial interruption') as well as Transco interruption. At present, any supply point that has

¹ Transco can call interruption for supply/demand balancing purposes when forecast national demand is greater than 85% of the forecast peak day demand.

daily metering and annual consumption in excess of 5.86 GWh can apply for interruptible status.

In terms of Transco interruptions, Transco distinguishes between Standard Interruptible (SNI) and Transco Nominated Interruptible (TNI) supply points. An SNI agreement allows Transco to interrupt the site for up to 45 days each year, while a customer with a TNI agreement may face greater than 45 days of interruption. 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. In return for having interruptible status, a customer receives relief from various charges including NTS exit capacity charges.

Existing interruption transfer arrangements

Under the existing interruption transfer arrangements, a shipper has two options for transferring a Transco interruption to a different supply point.

First, a shipper may elect to transfer a nominated Transco interruption at a supply point to an alternate supply point within the shipper portfolio.

Alternatively, the interruption may be transferred to a designated Partner Supply Point (or 'buddy'). A firm and an interruptible supply point may enter into an arrangement to be buddies, whereby the firm supply point agrees to be interrupted in the place of a specific interruptible supply point.

Winter Operations Report

Transco released its 2003/4 Winter Operations report in October. The report raised two key concerns with respect to the gas trading arrangements, namely that:

- ◆ There is a risk that winter security could be less than that necessary to meet 1 in 50 year winter demands. Transco's analysis is based upon an assessment of reduced beach availability (95% as opposed to 100%) and the historical use of storage to support interruptible demand over recent winters. As a result of this analysis, Transco have indicated that the level of gas security provided by national top up should be increased.
- ◆ Under prolonged cold conditions it might be expected that some or all CCGT generation plant will be interrupted under Transco interruptible contracts thereby reducing available generation in the electricity market. Transco indicated that under these conditions generation margins could be reduced to between a deficit of 0.1 GW and a surplus of 0.7 GW following interruption of CCGTs.

Transco considered these two risks to be 'worst case' scenarios with a low probability of occurrence.

The proposal

Modification proposal 0658 was raised by Transco. The purpose of the proposal is to extend the existing interruption transfer arrangements to enable the trading and transfer of Transco interruption obligations between gas shippers.

Under the proposal, a shipper that is willing to interrupt a site and effectively sell its gas back to the market may agree with another shipper to take on its interruption obligations. Transco intended the interruption transfer service to be used when an interruptible supply point that has received an interruption notification values continued firm supply more highly than another interruptible supply point. In particular, the modification proposal would enable interruptible CCGTs to transfer their interruption obligations if they were required to interrupt during a period of short supply in the electricity market.

In summary, it was proposed that the service would operate as follows:

- ◆ A register would be established and only shippers that are registered to use the interruption transfer service would be permitted to participate.
- ◆ If it is necessary for Transco to call an interruption, Transco would issue an Interruption Notification to the Primary Shipper that sets out a list of Transco selected supply points, a list of alternate supply points and the volume required to be interrupted.
- ◆ The Primary Shipper would respond with a Confirmation Notification that details the supply points and volumes that are to be interrupted, or of its intention to fulfil its interruption obligation by transferring part or all of its interruption requirements to one or more Alternative Shippers. The Confirmation Notification would include the volume of interruption to be transferred.
- ◆ The Alternate Shipper(s) would issue to Transco an Alternate Interruption Confirmation that confirms the supply points, and volumes, that are to be interrupted in response to the transfer of interruption from the Primary Shipper.
- ◆ To be valid, the Alternate Interruption Notification must be consistent with the Primary Shipper's Confirmation Notification. Otherwise, Transco reserves the right to designate the initially selected Primary Shipper's site/sites to satisfy the interruption obligation.
- ◆ Upon the Alternate Shipper issuing the Alternate Interruption Confirmation the Alternate Shipper will be liable for failure to interrupt charges. In the event that a valid Alternate Interruption Confirmation has not been received by Transco, the Primary Shipper will be liable for failure to interrupt charges.

There are constraints on the number of times that an interruptible supply point may be interrupted in any given year. Transco identified two options for attributing days of interruption. Under the first option, the interruption would count as a day of Transco interruption in respect of the supply point initially elected by Transco. Under the second option, the day of Transco interruption would be attributed to the supply point that is physically interrupted (the alternate supply point). If the second option was adopted, Transco would retain the right not to accept Alternate Interruption Confirmation Notices on the grounds that sufficient days of interruption must be maintained across appropriate locations to maintain security of supply.

Under the proposal, Transco, the Primary Shipper and the Alternate Shipper would communicate via facsimile and telephone.

Respondents' views

There were fifteen responses to the proposal. The majority of respondents opposed the proposal. In particular, a significant number of customers responded to the proposal and indicated their opposition.

Several respondents suggested that customers and shippers/suppliers have already entered into contracts for the winter period, and consequently customers were unlikely to be rewarded for being subject to increased interruption under the proposed arrangements. Several respondents stated that contracts were entered into on the basis of existing network code rules and that it is inappropriate to introduce changes to the network code at this time.

A number of respondents raised concerns that the proposal would give shippers the ability vary the level of interruption via a market based process without the customer being directly involved in such a decision. Some respondents also concerns that the proposal will lead to discrimination between different customers.

Many respondents also raised concerns that the proposal would increase administrative complexity and uncertainty within the interruptions arrangements. In this context a number of respondents raised concerns that the complexity of the proposal could lead to increases in the frequency of sites failing to interrupt thereby increasing security of supply problems for Transco. Respondents suggested that more sophisticated administrative arrangements would be required in order to introduce the interruption transfer service in a way that does not create uncertainty and confusion.

Several respondents expressed the view that the proposal was proposed too late to have any impact on the current winter, and that the take up of the interruption transfer service was likely to be low for the administrative and contractual reasons described above. Several respondents believed that the proposal was a 'band-aid' solution and that it was preferable to develop a more thoroughly considered approach in the broader context of exit reform.

A small number of respondents offered qualified support for the proposal. These respondents noted that the proposal could provide more flexibility to the existing arrangements and produce more efficient market based solutions by better attributing value to interruption than is currently the case. One respondent stated that it supported Transco's attempts to consider the interaction between the gas and electricity markets such that the proposal could allow gas fired generation to remain on by substituting interruption at other supply points.

Transco's view

Whilst Transco considers that the proposal has the advantage of introducing more flexible interruption arrangements for shippers and therefore beneficial trading opportunities, it nevertheless considers that, on the basis of representations received, that the effort of introducing the service for this winter would exceed any potential benefits, especially given the low expected take up of the service.

Transco expressed concerns that the modification proposal is critically reliant upon shippers effectively communicating the transfer of interruption obligations from one shipper to another.

Transco indicated that a failure in these communication arrangements could lead to higher levels of interruption.

Further, Transco noted that the principal objective of modification proposal 0658 – namely, to enable a more efficient allocation of interruption - could be undermined if contracts between shippers/suppliers and end use customers did not reflect the new arrangements. Transco stated that it was mindful of the fact that end user considerations might not feed into interruptible transfer decisions this winter.

Transco has therefore recommended that the proposal be rejected, with further work being undertaken in industry work groups to develop similar, more carefully considered, proposals for implementation next winter.

Ofgem's view

In principle, Ofgem is supportive of introducing arrangements that facilitate the trading of interruption obligations. Arrangements of this nature would normally facilitate beneficial and efficient trading opportunities and would be expected to facilitate effective competition between shippers and suppliers, thereby securing benefits for customers.

However, having considered the views of respondents, Ofgem does not believe that this proposal has been raised with sufficient notice for both customers and shippers. In this context, we are particularly mindful of the significant level of customer concerns regarding the timing of this proposal.

In particular, we consider that implementing this proposal for the forthcoming winter may actually undermine competition between shippers and suppliers to the extent that these parties have already contracted for their requirements over the winter period. Ofgem considers that, in general, the changes that have been proposed should have been brought forward well in advance of the winter period so that both customers and shippers could have taken the changes into account in negotiating contracts.

Ofgem notes that this proposal was raised largely to address concerns raised in NGT's Winter Operations Report. In future, Ofgem will request that Transco release this report at an earlier stage so that additional time and notice can be provided of proposals such as these that are raised to deal with potential security of supply issues.

Ofgem also has concerns regarding the potential effectiveness of the communications and administrative processes associated with any transfers of interruption obligations. In this respect, we are particularly mindful of the concerns raised by Transco as system operator that the proposal could actually increase the levels of interruption should shipper communication processes fail. For this reason, we are not satisfied that the proposal would better facilitate efficient system operation.

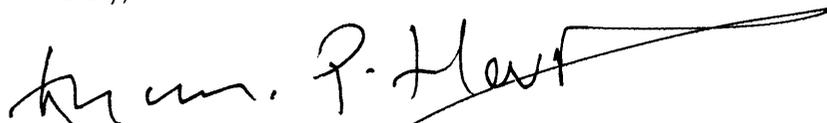
In summary, Ofgem agrees with Transco's recommendation to reject the proposal and to initiate work to develop similar, more carefully considered, proposals and necessary systems for next winter potentially as part of the broader exit capacity reform process.

Ofgem's decision

For the reasons outlined above, Ofgem has decided to reject modification proposal 0658, as we believe that it does not facilitate the achievement of the relevant objectives as outlined under amended standard condition 9 of Transco's GT licence.

If you have any queries in relation to the issues raised in this letter, please feel free to contact me on the number above or Mark Feather on 0207 901 7437.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Kyran Hanks', with a long, sweeping horizontal line extending to the right across the page.

Kyran Hanks
Director, Gas Trading Arrangements