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Dear Julian,

Urgent Modification Report 044: Revised Emergency Cash-out & Curtailment Arrangements.

Thank you for providing Scottish and Southern Energy plc with the opportunity to comment on the above urgent modification report.

Our comments are in four parts; firstly in respect of the Process, secondly in respect of the Modification, thirdly in respect of our Conclusions and fourthly a Summary.

Briefly, we believe that:-

- the process associated with Modification 044 is fundamentally flawed;
- Modification 044 is complex, confusing and riddled with inconsistencies;
- the proposal does not address the issues raised by the Proposer;
- the Modification could provide a perverse incentive on parties, which could worsen a gas emergency;
- the Modification is not fit for purpose; and
- Modification proposal 044 fails to better facilitate the achievement of any of the relevant objectives.

1 The Process

We are of the opinion that the process associated with this Modification proposal 044 is fundamentally flawed for a number of reasons (detailed in Annex 1) and, therefore, the Panel and the Authority must reject this Modification proposal 044 on procedural grounds.

2 The Modification

Turning to the Urgent Modification Report, we are of the opinion that the arguments put forward by the Proposer are fundamentally flawed for a number of reasons (detailed below) and, therefore, the Panel and the Authority should reject the Modification proposal 044.

a) Breaking the Law

We note the comments in the Urgent Modification Report that:-

“Any change to the cash-out price applicable during a GDE should ensure that Users do not have a financial incentive to withhold gas...and ensure that Users have an appropriate financial incentive to offer demand-side response”.

Irrespective of the arrangements within the UNC market participants are under a statutory duty to operate in a way that maximises available gas during a GDE, rather than withholding gas.

Therefore altering the emergency cash-out prices (for the suggested purposes of maximising gas availability) will no better achieve this goal than the current statutory requirements.

As an aside the inference with this Modification is that the existing statutory obligations placed upon shippers are not working; however, no evidence is provided within the Urgent Modification Report to substantiate this assertion.

b) Demand-side Response

There is an assumption within the Urgent Modification Report (and indeed the Authority’s Decision Letter for Modification 021) that there is an appreciable amount of demand-side response available for Users to utilize; but that they need have an “appropriate financial incentive to offer” it.

The Urgent Modification Report also indicates that:-

“Users should be encouraged to deliver and, where appropriate, provide demand-side response, in order to alleviate the extent and duration of the GDE”.

It seems that the Proposer, and perhaps the Authority, is under the impression that there maybe significant amounts of latent demand-side response waiting to offer itself into the market. Such an impression would be false. The fact is that end customers are free to chose if they wish a ‘firm’ or ‘interruptible’ contract. Most chose to take have a firm arrangement to minimize the disruption to their operations.

It is also not clear (once a GDE is underway) how the User could alleviate the duration of that GDE by virtue of having (or not having) demand-side response in place as, during a GDE, Transco NTS/the Transporter would interrupt any load irrespective of whether it had a ‘commercial’ interruption arrangement with a User or not.

To suggest, therefore, that by having demand-side response Users could alleviate the duration of the GDE is false as is the suggestion that amending the emergency cashout price could assist in this regard.

c) Marginal Value of Demand Response

It is stated in the Urgent Modification Report that:-

“Transco NTS believes that the cash-out price for Users with a negative Daily Imbalance should reflect the marginal value of demand response.”

It is not clear what the “marginal value of demand response” is?

Those end consumers who are taken off supply on the basis of ‘commercial’ interruption will receive the pre-agreed price (rather than any ‘marginal value’). Under Modification 044 the Firm load that is interrupted receives recompense at 30 Day SAP. How, therefore can a ‘marginal value’ be ascribed to demand response that justifies SMP Buy being applied (to the

User) for gas ‘obtained’ from end consumers at 30 Day SAP, particularly when these prices will not feed into the derivation of cashout prices.

d) Inability to Balance

This Modification 044 is based on the assumption that the risk that Users could be exposed to (SMP Buy) would encourage Users to balance in an emergency situation.

For example, the Urgent Modification Report states that:-

“If a marginal cash-out price applies to those Users that are short in a GDE then it should be possible for such Users to trade out their imbalances”.

However, this assumes (i) that Users are realistically able to react to these incentives and (ii) that there is a realistic market in existence with are other parties able, and willing, to trade at this stage, given the ‘command & control’ arrangements that are likely to be invoked by the NEC.

Reacting to Incentives

It needs to be recognised that emergencies are by their very nature different, depending upon circumstances. Some are 'progressive' in nature; for example, a general deterioration in the (forecasted) weather situation; whilst others are 'sudden'; such as an explosion (caused perhaps accidentally or deliberately by those seeking to cause harm to our society).

For a 'progressive' emergency it maybe that the market could, in an ideal world, be able to react in the way that appears to be envisaged by this Modification 044 proposal; although we have doubts that this would work in practice.

However, for a ‘sudden’ event (such as the catastrophic loss of a terminal, or a number of terminal, etc.) there will be little, if anything, that the market can do to prevent a GDE occurring. It would not, in such a situation, be a question of ‘reacting to an incentive’ as there are no meaningful actions that the User could take to either prevent or alleviate the GDE (it cannot fix a failure at a terminal!).

On a related point, it has been suggested by the Proposer that:-

“the current arrangements for the treatment of Emergency Interruption would not target the costs to those shippers who have contributed to the emergency”.

Equally the Authority, in its Decision Letter for Modification 021, states that:-

“During an emergency, the modification would ensure that those shippers that have a short position face a price for their failure to procure sufficient gas to meet the demands of their customers which is reasonably reflective of market conditions.”

For the reasons we outline below, we do not accept this applies to a ‘progressive’ event; and this certainly cannot be said to be the case for a ‘sudden’ event.

Events that occur out with the direct control of the User, such as the security/safety arrangement at a terminal (which are subject to Government and regulatory oversight), which may be linked to a ‘sudden’ GDE, cannot be said, by virtue of Modification 044, to be the responsibility of that User.

In the event of a 'sudden' GDE it cannot be asserted that a User has "failure[d] to procure sufficient gas to meet the demands of their customers" as the User could well have been in balance prior to the catastrophic loss of a terminal, or a number of terminal, etc., that was the cause of the GDE.

Accordingly, it is not possible to "target the costs to those shippers who have contributed to the emergency" (as those shippers have not contributed to the emergency per se).

A User could have taken all reasonable and prudent steps to balance their position. This they achieve prior to the 'sudden' event. However, for reasons totally out with their control their position is suddenly placed out of balance and they would, by virtue of Modification 044, be subjected to paying an extreme price.

This equates to the User receiving a penalty for the actions (or inactions) of someone else (out with their control) which cannot be said to be in accordance with natural justice or better facilitate the relevant objectives.

As an aside, we note that Transco NTS has also raised Modification 043 which, in essence, seeks to remove from it certain obligations placed upon it if events occur out with their control (such as planning/consenting issues etc.). It is hypocritical for it to be seeking to impose penalties on other parties to the UNC for actions out with their control whilst scheming to remove such penalties upon itself.

Lack of Parties to Trade With

It is asserted in the Urgent Modification Report that a User who finds themselves out of balance at times of a GDE could trade out of that situation.

However, in certain emergency situations market participants maybe unable to react to mitigate the significant additional risk that the proposed exposure to SMP Buy brings.

There are two aspects to this, Credit and Gas Availability.

- Credit

In respect of Credit the lack of 'immediate' information (minutes and hours, rather than days, later) means that some market participants could be at an inherent disadvantage in terms of knowing what their actual (physical, and thus financial) exposure position is (within the trading timeframe) due to the extreme price (SMP Buy) and unknown volumes that they could be exposed to, particularly given the uncertainty that surrounds the ECG and P70 process suggested with Modification 044.

Without this data they will find it extremely difficult, within the day, to accurately quantify their true exposure position. This, in turn, could lead, 'on-the-day', to the credit position of most trading parties being 'squeezed'(*) which, in turn, could force most, if not all, parties to curtail (or even cease) their market trading activities (with the potential for serious implications for market stability, liquidity and competition).

It should be noted that a 'sudden' GDE could occur at anytime, rather than 'conveniently' within the banking day (when additional credit may be available). At such a time the effect of Modification Proposal 044 would, in our view, be to 'dry-up' the gas market by virtue of its 'destruction' of the available credit. This cannot be said to better facilitate the relevant objectives.

Holding additional credit to deal with a 30% out of balance position (where a 'sudden' terminal centred GDE has pushed a User into a 'short' position) at an extreme SMP Buy price (which could be set on very low volumes of actual gas traded) would be a gross waste of resources which would have to be paid for, ultimately, by end consumers.

{* For example, if St Fergus were to be lost (due to a 'sudden' emergency) the market would assume parties are out of balance (by a theoretical figure of circa 40%?) and are thus exposed to the prevailing SMP for that volume which, in turn, uses up all the party's available credit with its counter parties.}

- Gas Availability

In the event of a 'sudden' GDE, such as the catastrophic loss of one or more terminals, there will be, by definition, a lack of gas available in the market. If this were not the case and there was gas available then why would Transco NTS not buy it?

Given this systemic lack of available gas to the User how does the Proposer think that the User (who finds themselves 'short' through no fault of their own) could obtain gas to make up this shortfall; noting that the Proposer, the NEC and Government have powers to compel parties to make gas available etc., powers which the User does not have.

e) Market Broken

We note that the Proposer has (in seeking to justify this Modification) made liberal references to the workings of the CORWG. However, in so doing the Proposer appears to have (conveniently?) overlooked the comments of CORWG (at its 4th February meeting) that:-

"Most of the group recognised the importance of having a neutral price when the market is effectively 'broken'."

It seems that when "the market is effectively 'broken'." the Proposer is seeking to introduce a penal mechanism to which market participants maybe unable to realistically respond.

Furthermore, we do not accept the Proposers' logic (vis incentives) for the reasons we have outlined elsewhere in this response. We believe that in an emergency that price, on its own, is less relevant; rather we think that in an emergency equilibrium is needed.

f) Windfall Gains and Losses

It is noticeable that the CORWG refers to cash-out being based on a principle of a party being held 'neutral'.

The approach suggested by the Proposer of Modification 044 will result in large amounts of funds flowing to and from parties throughout the market. Such an approach equates to some Users being subject to a windfall loss, whilst others, who took no discernable action to alleviate the GDE, would receive a windfall gain: this is hardly an approach based on a principle of a party being held 'neutral'.

It should also be pointed out that in a similar proposal within the electricity market (Balancing & Settlement Code Modification Proposal P173, proposed by NGT) it was stated that:-

"NGC also believe that the wider Industry should similarly not be exposed to losses or gains resulting from a 'relevant emergency instruction' through any consequential impact on Industry cashflows, including NGC's Balancing Services Use of System Charges. This (P173) Modification would only pass through those costs that would have reasonably and prudently

incurred as a result of the change in Exports and/or Imports caused by the 'relevant emergency instruction' ".

It is not clear to us that NG is being consistent in its arguments on the matter of cash-out arrangements surrounding emergency situations in gas and electricity (such as between UNC Modification 021 and BSC Modification P173).

Indeed, given that two Users have taken all reasonable and prudent actions and thus achieved a balanced position prior to the emergency, it is inherently wrong that User A is penalised (because it is placed into a 'short' position because of the action of others with whom it has not relationship/connection) whilst User B receives a bonus (again for nothing within its control).

It therefore follows that applying such an approach to the gas market would be distortionary and could not, therefore, be said to better facilitate the relevant objectives.

g) Cost of Actions Taken.

We note that in its Decision Letter for BSC Modification Proposal P135 that the Authority came to the view that it is essential that Energy Imbalance Prices provide appropriate signals to Parties by reflecting the costs that NGC incurs in undertaking electricity [energy] balancing actions, and that this is important for security of supply.

This is echoed in the Authority's Decision Letter with respect to Modification Proposal 021 which states that:-

"Cash out prices should reflect the costs incurred by the System Operator in balancing the system – for example, if the system is short overall, the cost of buying gas or demand side response."

Whilst this may well be the case where Transco NTS has actually bought physical gas or purchased physical demand-side response, this does not take account of gas obtained by Transco NTS for 'free' – that is it has not paid anyone for it (which would occur in an NEC 'command & control' situation).

This would be the case, for example, where Transco NTS interrupts load (such as firm load) or where demand for gas is reduced as a result of end consumers responding to public appeals for restraint (emanating from the Government, the Authority, Transco NTS itself, Users and others). In addition this does not factor into either 'normal' or 'emergency' cashout prices.

It is not clear to us what the actual cost to Transco NTS of interrupting load (be it firm or interruptible) is or the actual cost to Transco NTS of demand-side response freely provided by end consumers following public appeals is.

It is certain that as there is little, if any actual cost to Transco NTS of this demand reduction and it certainly in no way equates to the SMP Buy price.

Given that the actual cost of interruption (physical disconnecting end consumers) would be less than the SMP Buy price (if the Proposer's argument about Modification 044 providing a "financial incentive" is to be believed) it therefore follow that the signals to parties to reflect this actual cost also has to be low (and not set at the SMP Buy).

Given the Authority's views (with respect to P135) it therefore follows that applying such an approach to the gas market; in not reflecting the actual costs that Transco NTS incurred; could not, therefore, be said to better facilitate the relevant objectives.

As an aside, we would, as a minimum, expect Transco NTS to provide (on an 'open book' basis) an audited statement of all "the cost of buying gas or demand side response" that were "incurred by [it] in balancing the system". Only in this way could market participants be certain that profiteering and market abuse was not taking place.

h) Market Distortion

We note that in its Decision Letter for BSC Modification Proposal P135 that the Authority came to the view that Marginal Energy Imbalance Prices could potentially be distortionary, as they can be based on a very small volume of energy accepted by the SO, or alternatively based on a system balancing action.

We note that in the Urgent Modification Report, Transco NTS states that:-

"If there were a number of small quantity actions that could be taken that, in aggregate, would aid the overall Supply & Demand balance position, then Transco NTS would accept them. In these circumstances, it is Transco NTS's view that, as the highest priced action has helped to resolve the supply/demand imbalance, it is appropriate for it to set the cash out price."

It was confirmed by the Proposer, during the Transmission Workstream meeting on 11th August 2005, that under Modification Proposal 044 the price that parties who are out of balance pay could be set on very small volumes of gas.

Given the Authority's views (with respect to P135) it therefore follows that applying such an approach to the gas market would be distortionary and could not, therefore, be said to better facilitate the relevant objectives.

i) Market Manipulation

We note that in its Decision Letter for BSC Modification Proposal P135 that the Authority came to the view that there were additional concerns re the gas market, that a marginal price could increase the risk of manipulation to drive up Energy Imbalance Prices and market prices to levels that would not reflect underlying market fundamentals.

As this is a clear element of Modification 044, and in the light of Authority's views (with respect to P135) it therefore follows that applying such an approach to the gas market could not, therefore, be said to better facilitate the relevant objectives.

j) Penalising those that help

This Modification proposal 044 does not address the fact that UNC rules incentivise parties to balance by the end of the gas day. Therefore, in the scenario that an event occurs early in the gas day, and is of short duration, a party that was in balance before and during the emergency, but later goes out of balance, could be penalised even though they have, in respect of the emergency itself, had no discernible negative effect on the emergency situation at hand.

k) Targeting Costs on those that are not the main cause of the GDE

It has been suggested by the Proposer that:-

"the current arrangements for the treatment of Emergency Interruption would not target the costs to those shippers who have contributed to the emergency".

Equally the Authority, in its Decision Letter for Modification 021, states that:-

“During an emergency, the modification would ensure that those shippers that have a short position face a price for their failure to procure sufficient gas to meet the demands of their customers which is reasonably reflective of market conditions.”

However, generally much of the increase in demand for gas that arises from a ‘progressive’ GDE (as acknowledged in the Authority’s Decision Letter for Modification 021) is weather related. This will generally come from increased domestic demand, rather than from industrial or commercial end consumers yet the cost is to be born by those Users with industrial and commercial customers (who have contributed far less to the ‘progressive’ GDE).

This is discriminatory and cannot be said to better facilitate the relevant objectives.

Furthermore, we note the comments from Transco NTS, in the Urgent Modification Report, that:-

“The key difference is that we propose that the trade quantity should apply to the reduction of the offtake of gas at all System Exit Points other than those which comprise NDM Supply Meter Points and Priority Supply Points. These excluded loads are protected by the GSMR Safety Monitor under the NEC Safety Case and it would be inappropriate to incentivise a demand response at such Supply Points as it would not be possible to accept or validate a market based demand response.”

Given that in the run-up and during a GDE (of a ‘progressive’ or ‘sudden’ variety) all stakeholders (Government, the Authority, Transco NTS, Transporters, Shippers etc.) should be doing everything (e.g. public messages from the JRT, TV, radio and newspaper messages etc) they can to encourage end consumers to curtail demand for gas; it is perverse that Users are to receive no credit for reductions in the demand of gas achieved by their consumers. It would seem that Transco NTS wish to remove this ‘credit’ for its own ‘benefit’ rather than the User.

l) P70 ‘Grid Lock’

We note the comments in Section 4 of the “Notification of Demand side curtailment to relevant Transporter – Proposals put forward in UNC Modification Proposal 0044” paper circulated on 15th August 2005 regarding the “Potential exposure if P70 is not submitted”.

Given this statement from Transco NTS it is clear that a User has no choice but to submit not only a P70 for its ‘commercial’ interruption end consumers (as required by the UNC) but also that the User will have to notify Transco NTS/the Transporter where firm customers alter their requirement for gas.

This will clearly lead to (i) a flood of faxes to-from Transco NTS/Transporters/Users and (ii) a flood of phone calls to-from Transco NTS/Transporters/Users.

Thus at times of a GDE what can be certain, if Modification 044 is approved, is that there will be communication ‘Grid Lock’ between Transco NTS, Transporters and Users. Rather than seeking to manage the GDE and minimise its impact, Transco NTS, Transporters and Users will have to utilise precious staff resources completing/sending/handling faxes and making/receiving phone calls.

This raises some significant concerns. We believe the primary function of Transco NTS, Transporters and Users should be to manage the GDE and address any safety related call/faxes that they may receive.

If they also having to handle a flood of P70 faxes and phone calls then the staff on duty would, in our opinion, be overwhelmed (particularly in the event of a 'sudden' event).

If Transco NTS has complete confidence in its systems then it will be happy for the industry to test this by the industry picking a time/day to 'flood' Transco NTS with 'exercise P70' faxes and calls.

Given that if a User fails to notify Transco NTS/the Transporter of a "Reduction of Offtake at Firm Supply Points" they will be liable to SMP Buy then, if Modification 044 is approved, Transco NTS should be required to keep the User whole, in all respects, to ALL costs that the User incurs as a result of ANY failure on the part of Transco NTS to accept, handle or process any faxed P70 forms or phone calls to notify a "Reduction of Offtake at Firm Supply Points" (as detailed in new paragraph 1.20 of the legal text of the Urgent Modification Report).

As an aside, we note that what Transco NTS is proposing (with Modification 044) is in addition to the existing UNC requirements vis notification of renominations etc.,: is Transco NTS saying the current UNC requirements are insufficient?

m) Emergency Curtailment Quantity

We note the complete confusion that the Proposer has with respect to what process it to be followed where gas is interrupted prior to and during a GDE being included within the Emergency Curtailment Quantity ("ECQ").

In the Urgent Modification Report the Proposer states that:-

"For each User, the Emergency Curtailment Quantity would be calculated as the aggregate quantity of Emergency Curtailment occurring as a result of a potential or actual GDE at the relevant System Exit Points less any quantity of User commercial "interruption" at the same System Exit Points notified to the relevant Transporters prior to the Emergency Curtailment occurring."

However, in the "Notification of Demand side curtailment to relevant Transporter – Proposals put forward in UNC Modification Proposal 0044." paper circulated on 15th August 2005 the Proposer states that:-

"the requirement to submit a P70 "firm" form would not be limited to the period of a Network Gas Supply Emergency or Potential Network Gas Supply Emergency. A P70 would be required at either Firm or Interruptible System Exit Points at any time where the User has exercised an entitlement to require the consumer to discontinue consuming gas from the Total System."

Thus, in the Urgent Modification Report it refers to that quantity of gas "notified to the relevant Transporters prior to [the GDE]" whilst the P70 note implies it to applies to all quantities of gas notified before, during and after the GDE. Which is correct: it cannot be both?

In addition, the Legal Text only refers to the User notifying the Transporter where the User:-

"exercises...any entitlement to require the consumer to discontinue consuming gas off-taken from the Total System on a Day".

However, it does not take account of circumstances where the end consumer freely chooses to discontinue using gas (perhaps in response to a public appeal from the Government, the

Authority, Transco NTS, its Shipper etc.) and the User notifies the Transport of this. What is the legal position of that notification?

Also what happens with regard to a new site where data on consumption may not be sufficient to allow the User to provide accurate figures with respect to the likely quantity of gas demand that maybe interrupted at the end consumers' site?

Furthermore, we note that the methodology used by each Transporter to calculate its element of the ECQ could be different.

For example, the Urgent Modification Report on page 6 refers to the "methodology each Transporter may use", whilst at page 8 it refers to "a single methodology, comprising a number of distinct steps, covering all relevant System Exit Points could be applied by all Transporters".

Clearly the reference to "may" and "could", rather than "must" and "should", means there is no compunction for any of the Transporters to follow the methodology suggested by Transco NTS. This is a potential receipt for confusion, duplication of effort and waste of resources, particularly on the part of Users who would receive a ECQ volumes potentially calculated via a variety of different means. The User would have to familiarize themselves with each of these different means of calculation before deciding if it was correct and then make a claim, noting that the timeframe for submitting a claim has still to be stated.

n) ECQ Claims Process

We note the comments in Section 4 of the "Notification of Demand side curtailment to relevant Transporter – Proposals put forward in UNC Modification Proposal 0044" paper circulated on 15th August 2005 that "if an end consumer intends to curtail its offtake of gas for the rest of a Gas Day but does not inform its User" there would be a error with the User's ECQ volume.

However, how will a User (i) know of this reduction in demand by its end customer and thus be able to submit a make a claim (about an error with the ECQ) given that Section 4 goes on to say that:-

"Such [a] claim submission would require further evidence from the end consumer to support the claim."

It is clear from the 15th August 2005 paper that Transco NTS accepts that end consumer self curtailment of gas demand is likely to be unknown to the User. Nevertheless they propose that Users be subjected to paying SMP Buy for this volume of gas.

It seems that where end consumer cut their demand it is not their User who benefits (but Transco NTS/the system?) but instead the User pays a penalty on a volume of gas demand supposedly (but not actually) taken by their end consumer. How can this be reasonable, equitable or better facilitate the relevant objectives?

o) The Cause of the GDE

It is clear to us that the scenario leading to the GDE will influence behaviour. For example, if there were to be a shortfall in coal based generation (due perhaps to limitations associated with the EU ETS etc.), then the price for electricity maybe high and parties would be incentivised to increase their supplies of electricity, leading to an increase in demand for gas which might cause a gas supply deficit.

p) Compatibility with Modification 035

It is not clear how Modification proposal 044 will fit with the Safety Monitor changes detailed in Modification 035.

q) Legal Drafting

There are a number of issues raised in the Legal Text contained within the Urgent Modification Report.

It is proposed that there is a new requirement placed upon Users; where demand management/commercial interruption (or reinstatement) takes place at Firm supply points; for User to inform relevant Transporter within one hour of the discontinuance or at least one hour before resumption. This includes an estimate of impact on volumes of gas offtaken.

However, this in addition to the existing UNC obligation to inform the Transporter of same at Interruptible Supply Points. It is not clear why this is needed in addition to the revised OPN/DM Renomination information, which will already be provided by the User to the Transporter.

We note that the legal wording defines emergency curtailment quantity as emergency interruption or firm load shed. It goes onto indicate that the emergency curtailment trade price will equal the 30 day average SAP on the day before the curtailment occurred.

However, neither these volumes nor these quantities are used in cashout price derivation.

If the emergency curtailment is supposed to be a proxy for demand side bid – why is this not factored into cashout when only interruptible loads are involved?

If it doesn't feed into cashout then what is the point of paying someone for emergency interruption(?), particularly when they can decide whether to sell their additional gas into the market or use it to balance rest of portfolio, given that the volume will be excluded from their prevailing imbalance position?

We note that it appears that Transco NTS will carry out an NBP disposing nomination and that the User will be deemed to have made an acquiring nomination for that volume, and they will be paid the ECT. However, it is not clear where the money for this payment will come from!

It is not clear whether the User will be able to view their imbalance real time on the NBP screens.

We note that the Legal Text outlines a disputes process to be followed if the ECQ is wrong, whereby a claim is submitted, by the User, to Transco NTS, who appoints an independent reviewer to examine the claim and determines whether justified. We assume that there is an ability for a User to appeal any decision by the independent reviewer to the Authority.

In respect of the handling of any claims actually made, who pays for this as we cannot see this within the Legal Text.

3 Conclusions

In conclusion we believe that Modification 044 does not better facilitate any of the relevant objectives for the reasons detailed above and in Annex 1 as well as those outlined below.

a) Fix what needs to be fixed

If the aim is to encourage the ‘right behaviour’ within the gas market then the solution should be based on fixing the cashout arrangements, rather than the emergency arrangements. If Modification 044 were to be approved it would, in our opinion, confuse rather than clarify the situation surrounding an emergency. In an emergency we all need explicit clarity of what happens. Modification 044 does not achieve this, as its as ‘clear as mud’ what parties should do.

b) Cashout price

Modification 044 (along with Modification 042) proposes to introduce a sharper cashout price that is supposed to be more reflective of market fundamentals on the day than the prevailing 30 day average SAP. Given that the cashout price applies to Users’ imbalances in an emergency, when the market has been suspended and we are in a command and control situation, cashout should not be so penal as to send parties out of business or give people windfall gains.

Once the market is into a command and control situation it is not clear to us how Users can continue to be financially incentivised to balance. First and foremost they must do what they are told to maximise supplies and limit demands on the network. The NEC is in charge.

However, if the emergency cashout price is too penal (e.g. SMP Buy) people might hold more gas in reserve for themselves in the lead-up to a GDE which would be a perverse incentive and not what’s best for the system. In an emergency it is not about managing the commercial/financial position but about helping the network and avoiding the escalation of an emergency.

Fundamentally, how can Users meet the incentives to balance their portfolio in a command and control situation.

c) Europe

As witnessed by events earlier this year, we are of the opinion that an emergency cashout price is unlikely to have any influence on gas supplies turning up from Europe. Again, by the time emergency cashout is invoked, we are into command and control, and the Interconnector will be told to import if it can.

d) Lack of OTC Market

There seems to be some confusion between the statements in both the Modification proposal 044 and the Authority Decision Letter for 021 about the ability to trade during an emergency, when compared with the current wording in the UNC.

At present, under UNC rules, once a Stage 2 emergency is declared, then Section C of the UNC doesn’t apply, i.e. there is no OTC market.

As an aside, even if the OTC market were to be in existence at the time of an emergency who, realistically, would be trading anyway, given that if they “sell” to Transco NTS they can always appeal if the amount they receive, via the emergency cashout price, does not adequately recompensed them for the costs they have incurred. They would have no such right of ‘appeal’ if they had sold on the gas to another party.

e) Economic and Efficient Operation of the Pipeline System

Noting the Authority's comments in its Decision Letter for 021, we are somewhat perplexed as to why the Authority thinks that basing the cashout price, in an emergency, on SMP Buy will promote economic and efficient operation of the pipeline system.

f) Process flawed

In our view the process followed, with respect to Modification 044, is flawed and inconsistent.

Furthermore, Modification 044 is unnecessarily confusing, complex and riddled with inconsistencies between the Urgent Modification report, the proposed Legal Text and the 'clarification' notes. This stems from the fact that Modification 044 is insufficiently developed.

In addition we are not clear that it is permitted, within the rules for dealing with modification proposals, for the Proposer to issue "clarificatory notes" part way through the consultation process.

Was this accepted by the Authority? The Authority's Decision Letter, granting urgency to Modification 044, does not appear to indicate that the Authority did accept this approach.

We have concerns about this as we have heard that the Legal Text could be refined (by the Proposer) prior to the Panel recommendation, but without other parties to the UNC having an opportunity to see, or comment on the revised Legal Text.

As a minimum interested parties who have responded MUST see, and be able to provide comments on, the Final Modification Report given the commercial significance that the proposed change amounts to.

g) Duel Cashout

We do not support the proposition, in Modification 044, that in an emergency situation duel cashout prices are appropriate.

The primary focus should be for all stakeholders in the industry to do what ever they can, as reasonable and prudent operators, to fully conform with their statutory obligations (vis the NEC/Safety Case etc.).

In such a situation the penalty associated with duel cashout prices (particularly when based on an 'extreme' price, such as SMP Buy) is wholly inappropriate.

h) ECQ

The definition of "Emergency Curtailment" and Emergency Curtailment Quantity" is confusing.

Furthermore, it is not clear how the ECQ title trade will work in terms of the User knowing at any point in time what their imbalance position actually is.

There doesn't, for example, appear to be any obligation upon Transco NTS to do trade within certain timeframes. Or to tell the User that a trade has been executed.

Where will the NBP trade be posted? How will you be notified?

We note that the Transporter will calculate its element of the ECQ. This is based on its a reasonable estimate (using a methodology that may not be known to the User) of what would have been offtaken had there not been emergency curtailment. This information has to be passed to Transco NTS as soon as reasonably possible. After the GDE event the Transporter will be obliged to pass User specific data regarding the ECQ volume calculations within D+4. This is for reconciliation purposes.

Why will the methodology to be used by Transporters (to calculate the ECQ) not be contained within the UNC?

4 Summary

It is clear to us, for the reasons detailed in our comments above, as well as in Annex 1, that Modification proposal 044 does not better facilitate any of the relevant objectives and, in summary, SSE is firmly opposed to the implementation of any aspect of this proposal.

I hope that our comments have been helpful. Please do not hesitate to contact me in the first instance if you wish to discuss any of the points raised in our response.

Yours sincerely

Garth Graham
Market Development

Annex 1: Flaws in the Process associated with Modification 044

There are, in our opinion, a number of reasons (detailed below) why the process associated with this Modification proposal 044 is fundamentally flawed and, therefore, the Panel and the Authority must reject this Modification proposal 044 on procedural grounds.

a) Urgent Modification Proposals

We note the comments in the Authority's Decision Letter with respect to Modification Proposal 021 ("Revision of the Emergency Cashout Arrangements") with regard to the fact that "it must reject the modification proposal [021] on procedural grounds" and, subsequently, "Ofgem considers that Transco NTS should, as a relevant gas transporter, alongside other relevant gas transporters, urgently review its procedures including the Joint Office to ensure that no such material deficiencies in the process of urgent modification proposals arise in the future."

Transco NTS, at the Transmission Workstream meeting on 11th August 2005, stated that this urgent review of the procedures for handling urgent modification proposals has not been performed.

This was confirmed in a note from Transco NTS circulated on 17th August 2005, where they stated that:-

"We have reviewed our processes... in providing information for this modification and in the process we proposed for urgency."

We note this internal review by Transco NTS (according to comments on the 11th and 17th August 2005) was not undertaken "alongside other relevant gas transporters". Furthermore, given the repeated comments about openness and transparency from NG in the past, we are surprised that Transco NTS has not published details about their internal review's terms of reference, deliberations or conclusions.

Accordingly, given that there has been no review; by "Transco NTS... as a relevant gas transporter, alongside other relevant gas transporters"; then the "material deficiencies in the process of urgent modification proposals" must, by definition, remain.

It would seem, therefore, that stakeholders are being asked to have faith in the process to be followed for this Modification 044 which, according to the comments of the Authority with respect to Modification 021, is fundamentally flawed.

b) Section Q Review

We note the comments in the Authority's 021 Decision Letter that:-

"Transco NTS further stated that the relevant section of the UNC (Section Q) is currently under review and acknowledged that this is an area where greater clarity is desirable prior to this coming winter. Transco NTS has undertaken expediently to bring forward modification proposals following this review. Ofgem welcomes the review that Transco NTS is conducting and considers that it would be important for there to be clarity in this area in order that shippers could be confident that the modification would operate as intended."

However, this statement from Transco NTS "that the relevant section of the UNC (Section Q) is currently under review" appears to be at odds with the note from Transco NTS circulated on 17th August 2005, which states that:-

“Transco NTS has publicly expressed its intent to initiate a review of UNC TPD Section Q”.

The issue centres on “intent to initiate” verses “currently under review”. The 17th August note implies something is ‘to’ happen, whilst the Authority Decision Letter implies that something ‘is’ happening: which is it, as it cannot be both.

If a review is currently underway then, given the repeated comments about openness and transparency from NG in the past, we are surprised that Transco NTS has not published details about their internal review’s terms of reference, deliberations etc.

In addition, as stated at the Transmission Workstream meeting on 11th August 2005, and the 17th August note, this review of Section Q (i) has not concluded and (ii) is not expected to be completed for this winter.

Clearly, if Modification 044 were to be approved, as the Section Q Review will not be completed prior to its implementation then, in the words of the Authority, “shippers could [not] be confident that the modification would operate as intended”.

For the avoidance of doubt, if Modification 044 were to be approved, it is certainly our belief that without the successfully conclusion of a review of Section Q that we, as a shipper, could not be confident that the modification 044 would operate as intended.

c) Undertaking given to the Authority

We note that according to comments in the Authority’s 021 Decision Letter that:-

“Transco NTS has undertaken expediently to bring forward modification proposals following this review [of Section Q]”.

However, Transco NTS has brought forward a modification proposal for consideration prior, rather than following, this review of Section Q. For the Authority to allow this Modification 044 to proceed would seem to bring into question the value of the undertaking given by Transco NTS to the Authority.

d) CORWG

As with Modification 021 we note that Modification 044 makes reference to the workings of the Cash-out Review Working Group (“CORWG”).

As participants in the CORWG we are somewhat surprised that the Proposer seems to have come to such definitive conclusions (which warrant urgent Modification Proposals 021 and 044 being raised) when neither the CORWG or Ofgem have come to any definitive conclusions with respect to cash-out.

As you may recall the CORWG was 'suspended' by Ofgem just before Easter, and has still to restart. Prior to this the group considered a number of issues that relate to cash-out, including gas emergencies. However, the group had neither concluded its overall deliberation of all the interrelated issues associated with cash-out nor come to any conclusions on the suggested way-forward.

Nevertheless this has not prevented the Proposer from selectively quoting (from a still to be completed process) in seeking to justify urgent Modification proposal 044. We feel it is premature, and somewhat unhelpful, for the (CORWG) process which was initiated by the Authority (to which industry parties provided significant resources) to be 'used' by a party to justify a major change that directly relates to the outcome of the (CORWG) process itself.

A further consequence of this Modification, it would seem, is to fetter the discretion of Ofgem with respect to the deliberations and outcome of the CORWG. Given that CORWG is 'suspended'; it seems highly likely the Authority will be asked to give its views on the gas elements of cash-out (by virtue of having to urgently consider Modification Proposal 044) without itself having reached any conclusions on the outcomes of CORWG.

e) Timing

It seems there is a pattern emerging of urgent proposals being put forward (in both the gas and electricity areas) in the late spring/summer which have the potential to profoundly alter the fundamental operation of the market.

As 'urgent' propositions they are hastily progressed through the change process with the time for consideration and debate curtailed. It seems that at a later date amendments are then put forward to improve on these initial 'urgent' propositions which could (or should?) have been addressed at an earlier stage had time allowed.

It is for this reason that we welcomed the CORWG process as it proceeded in a structured, considered, comprehensive and fully inclusive way to address the issues associated with cash-out in both gas and electricity (as well as the interactions between the two markets).

We therefore agree with the comments in the Authority's 021 Decision Letter that "the Authority considers it regrettable that the proposal was not raised earlier in the year to allow more time for consideration before the winter" and believe this also applies even more so to Modification 044 (given the even shorter time for stakeholders to consider its effect prior to the winter).

These radical, rapid changes to fundamental aspects of the market can only lead to a significant increase in market uncertainty prior to this winter which cannot be said to be conducive to the public good.

f) Incomplete and Flawed Solution

A Gas Deficit Emergency can be caused, generically, in one of two ways; either a 'progressive' set of circumstances (such as deterioration in the weather) or a 'sudden' event (such as the catastrophic loss of a terminal, or a number of terminals, etc). Therefore Modification 044 has to address both types of causations of a GDE otherwise it must, by definition, be an incomplete, and thus flawed, solution.

We note that there has not, as yet, been a GDE and therefore we wish we had the same confidence as the Authority when it asserts (in its Decision Letter on Modification 021) that:-

"it is highly unlikely that a gas deficit emergency will not be progressive given the nature of the gas system as in most circumstances it is likely that a GDE will be a consequence of severe weather conditions" and that "the probability of a GDE occurring rapidly, as a result of, for example, an incident is therefore very low".

Regrettably, however, we live in dangerous times. We are mindful, for example, of the comments of the Home Secretary, speaking on 15th August 2005 about recent events who stated:-

"It would be absolutely foolish for me or anyone else to say we have eliminated the risk. We are working based on the idea that the people who organized these attacks are planning more."

In our view the possibility of a sudden event (as the cause of the GDE) has to be factored into any meaningful assessment of this Modification proposal (rather than being considered over the coming months).

It is clear that Modification 044 attempts to only offer a solution to a GDE caused by a 'progressive' set of circumstances and that it does not address a GDE linked to a 'sudden' event, such as an act of aggression by those seeking to do harm to our society.

In light of this it can only be concluded that Modification 044 is incomplete and flawed and therefore cannot be said to better facilitate any relevant objectives. To approve such a Modification knowing that it does not offer a solution to the causations of a GDE would also bring the modification process into disrepute.

g) Industry Sessions

We note the comments from the Proposer in the Urgent Modification report that they "will set up industry sessions to discuss the ECQ processes during the consultation process".

We further note that there was a Transmission Workstream meeting on 11th August 2005 at which the parties were able to put question to the Proposer. However, such questions were strictly limited to points of clarification about the Modification 044 (including the ECQ process). There was no ability to discuss(##) the ECQ processes.

There has not, to our knowledge, been any other "industry sessions to discuss the ECQ processes during the consultation process".

Accordingly; as there have been no "industry sessions [plural] to discuss [as opposed to clarify] the ECQ processes during the consultation process"; the Proposer has failed to conform with the process for inclusive consultation on a key element of Modification 044.

{# 'Discuss' is defined in the Concise Oxford Dictionary, 9th Edition as:- "...examine by argument...debate".}