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CODE MODIFICATION PROPOSAL No.0071
"User Compensation for NEC Storage Curtailment"
CODE MODIFICATION PROPOSAL No.0071a
"User Compensation for NEC Storage Curtailment"

Dear Julian,

Thank you for your invitation seeking representation with respect to the above Modification Proposals.

Given the significantly reduced timescales this response is necessarily short and therefore only covers the key issues raised by Modification Proposal 0071 and 0071a

National Grid NTS supports the implementation of Modification Proposal 0071 and does not support Modification Proposal 0071a. Below is National Grid NTS's detailed response to the Modification Proposals:

1. The Modification Proposal

UNC Modification Proposal 0052 was implemented on 5th December 2005. This sought to compensate Users, affected by the NEC requesting a curtailment on storage withdrawals, by deeming a gas trade to have taken place between the User, as purchaser, and National Grid NTS, as seller. (Acting as the residual system balancer and therefore funded through the Balancing Neutrality arrangements) for which National Grid NTS receive consideration equivalent to the prevailing 30 day SAP price. The effect of this trade is to correct the User's imbalance created as a result of the curtailment and thereby is likely, in our opinion to result in increased market activity by the residual balancer. In our response to this Proposal we did not consider that such an increase in the residual balancer's role would be consistent with the relevant objectives set out in our licence.

In its decision letter for 0052 Ofgem recognised that the proposal contained a number of deficiencies. In particular Ofgem stated that “alternative forms and levels of compensation should be considered” and “there may be merit in compensating parties through a simple cash payment rather than a deemed trade that removes imbalance exposure”.

Proposal 0071 seeks to address the deficiencies created by Proposal 0052. It aims to achieve this by replacing the gas trade element of 0052 with a simple cash payment, by National Grid NTS to Users, as compensation for the storage withdrawal curtailment and by removing the potential ability of Users to make multiple claims on the same gas in any subsequent curtailment periods.

Proposal 0071a has a different (and in our opinion more complex) compensation structure and is unclear in a number of respects which may lead to the possibility of a User being inappropriately compensated for a quantity of gas in storage that it has received through a storage transfer trade, when another User has already been compensated for the curtailment of that same gas.

The key difference between Proposal 0071 and 0071a is the way in which the compensation payment is determined. Proposal 0071 suggests that the appropriate level of compensation should be the System Average Price on the day of NEC requested curtailment minus the original cost of the stored gas and the storage injection and withdrawal costs.

Proposal 0071A suggests a different arrangement and a two stage approach; The first stage is that Users receive an interim payment of the System Marginal Buy Price minus the 30 day System Average Price.

The second stage is a reconciliation that takes place at least 30 days after the end of the relevant curtailment period and would mean that the final compensation payment is the SMP_{buy} price minus the 30 day post emergency SAP price and the injection costs.

The key issues with this approach can, in National Grid NTS' view, be summed up in two areas

(i) Appropriateness of the Compensation Payment

It has been suggested in discussions at the Transmission Workstream that proposal 0071 would in most circumstances produce a compensation payment that is inappropriately low and would not incentivise Users to keep their gas in storage. We disagree with this view and believe that the proposed payment is appropriate. By definition Users should, on average, be able to trade at SAP on the day. It is surely appropriate therefore that the basis of any compensation payment should start with SAP. Using SMP_{buy} as a base price (as proposed in 0071a) would, in our opinion, over compensate the majority of Users and, whilst this prospect of over compensation may provide a bigger incentive to retain gas in store, it may distort the market in favour of Users affected by a storage curtailment. The aim of 0071 in contrast is to provide Users with appropriate compensation not too much compensation.

Regarding the second element in the compensation formula, 0071 uses the average summer SAP for the previous summer whilst 0071a uses the post emergency 30-day SAP price. Modification Proposal 0071 provides a clear ex-anti level of compensation

to which Users and market facilitators can respond in real time whilst 0071a includes a significant ex-post element that will result in uncertainty in real time and indeed up to at least 30 days after the curtailment event.

It is the understanding of National Grid NTS that the post emergency 30-day SAP value used within 0071a is as a proxy for the value that curtailed gas might have when it is withdrawn post curtailment. If this is the case then it should be noted that the volume of gas under the safety monitor could be withdrawn in as little as four days and hence it is questionable as to whether the 30-day average SAP is a good proxy for any gas remaining in storage post emergency.

(ii) Simplicity of Process

The process associated with proposal 0071 has the undoubted advantage of being simpler than that required for 0071a. By settling the compensation issue within one business day of the curtailment 0071 allows Users to retain certainty over their anticipated costs and revenues. Modification Proposal 0071a on the other hand would take at least a month before affected Users would have certainty about how much they are going to receive in compensation for the curtailment, and potentially longer where separate curtailment periods are not separated by a period of 30 days or more continuous non-emergency operation. This uncertainty may drive inappropriate behaviours in some Users and uncertain indebtedness positions. It is worth noting that since the compensation payments are to be paid from Balancing Neutrality, all Users will be affected by this uncertainty.

Also the two stage approach proposed in 0071a is inherently less efficient than the single stage approach proposed in 0071 as it will require additional administration process and billing arrangements including new charge items which may result in a delay to its implementation.

As part of Modification Proposal 0071a the proposer states, "We trust that Ofgem will oblige NG NTS to bear a proportion of the costs of compensating shippers in future, rather than requiring the whole amount to be borne by shippers who will ultimately pass through these costs to customers." National Grid NTS reiterates that its role in respect of balancing the Total System is carried out in the context of a residual role and not primary. Users bear the primary responsibility for procuring sufficient gas to meet the contracts they have signed with their end consumers. To the extent that, as a community, Users do not secure sufficient supplies then it is the responsibility of all Transporters to secure the safe and continued operation of the Total System. This is achieved by both safeguarding the necessary supplies (including storage) and, where necessary, requiring the safe isolation of non-priority loads. The NEC undertakes this 'joint' Transporters role, on their behalf. We do not believe that it is appropriate to incentivise National Grid NTS during this period, as it is acting under Health and Safety legislation, its duties under GSMR and under direct instruction of the NEC. We note that such NEC instructions and duties would leave little if any opportunity to respond to commercial incentives.

It should be noted that the Safety Monitor arrangements are in place to seek to ensure safety through one-in-fifty security of supply for those end-consumers not 'protected by isolation' i.e. the

Safety Monitor protects those NDM and priority end consumers that are 'protected by monitor'. None of those consumers protected by the Safety Monitor are directly connected to the NTS and hence National Grid NTS would find it difficult to respond to an incentive by taking actions, which might reduce the number of consumers that need to be protected by monitor. Only those Transporters with directly connected consumers that are 'protected by monitor' are in a position to respond to such an incentive, but as previously stated all Transporters during this period are responding to the primary duties under their respective safety cases and the instruction of the NEC.

2. Extent to which implementation of the proposed modification would better facilitate the relevant objectives

As stated in the Proposal document, we consider that Proposal 0071, if implemented, will better facilitate the following relevant objective as set out in our GT Licence:

In respect of paragraph 1.a): we consider that both Proposals 0071 and 0071a may improve *“the efficient and economic operation of the pipe-line system”* by ensuring that Users continue to be incentivised to balance their own portfolios by contributing to the physical balance of the Total System and therefore help ensure that the market activity of the residual balancer is restored to the more efficient level it was at prior to the implementation of UNC Modification Proposal 0052.

In respect of paragraph 1.a): we note that the proposer of Modification Proposal 0071a states that it's Proposal, "will improve *“the efficient and economic operation of the pipe-line system”*, by avoiding inappropriate 'smearing' of compensation costs across all shippers where this is not justified". We feel unable to support this view, as 0071a does not seek to change the existing smearing process. The proposed costs generated as part of both 0071 and 0071a would be smeared through the prevailing Balancing Neutrality Mechanism.

In addition, in respect of paragraph 1.e): we consider that Proposal 0071 might improve *“the provision of reasonable economic incentives for relevant suppliers to secure that the domestic customer supply security standards are satisfied as respects the availability of gas to their domestic customers”* by providing appropriate compensation to Users affected by a NEC requested storage curtailment whilst ensuring that each User retains an incentive to balance its portfolio within the Day.

National Grid NTS do not consider the compensation proposed in 0071a to be appropriate. Therefore we do not consider that 0071a will further paragraph 1.e as it would reduce the incentive to avoid cashout exposure.

3. The implications for Transporters and each Transporter of implementing the Modification Proposal.

i. Implications for operation of the System

Both Proposals will restore National Grid NTS's role of residual balancer back to the more efficient level that existed prior to the implementation of UNC Modification Proposal 0052.

ii. **Development and capital cost and operating cost implications:**

Both Proposals seek to reduce the role of the residual balancer to the extent that this role has been increased through the implementation of Modification Proposal 0052 and will therefore save the costs associated with the potential additional trades and processes we anticipated as a result of UNC 0052. Proposal 0071a will however involve additional operating costs as a result of the two-stage compensation process.

4. The implications of implementing the Modification Proposal on security of supply, operation of the Total System and industry fragmentation

By ensuring that the User's imbalance is restored to its pre 0052 position short-term security of supply is enhanced by both Proposals.

By compensating Users for the curtailment of the gas they hold in storage and thereby helping to protect the Safety Monitors long term security of supply is enhanced by both Proposals.

5. The high level affect on the UK Link System and other related Systems for Transporters and Users

Minor systems changes or manual workarounds may be required for both proposals.

6. The implications of implementing the Proposal for Users

Proposal 0071 will ensure that Users affected by a curtailment of Storage Withdrawal will receive an appropriate compensation payment and be incentivised to restore any imbalance positions. Additional operational costs associated with submitting claims, etc are believed to be lower than those associated with the current, post UNC 0052, regime and any arrangements that would exist if proposal 0072a were to be implemented.

Users unaffected by the curtailment of Storage Withdrawal will benefit as a result of a likely reduction in the buying activity of the residual balancer that would have otherwise been funded through neutrality.

7. The implications of implementing the Modification Proposal for Terminal Operators, Consumers, Connected System Operators, Suppliers, producers and any Non Code Party

No material effects are anticipated in this area.

8. Analysis of any advantages or disadvantages of implementation of the Modification Proposals

a Advantages:

Both Proposals;

- will ensure that the incentive on such Users to balance within the Day is maintained thus helping to ensure that the market activity of the residual balancer is restored to an efficient level.

Proposal 0071;

- will provide appropriate compensation to Users affected by storage curtailment activity requested by the NEC resulting in the retention of a User's incentive to contribute to the physical balancing of the system.
- ensures that Users cannot successfully make multiple claims for the same unit of gas. This includes gas transferred to a User as a result of a storage transfer,

b Disadvantages:

Both Proposals;

- neither Proposal prevent a User from obtaining an additional benefit from the gas it holds in Storage, by withdrawing it on a day after the curtailment period, when the market value of the gas may be higher than the potential value that was compensated for.

Proposal 0072a;

- we consider that this Proposal over compensates Users affected by storage curtailment
- is unclear in its intent regarding compensation for gas obtained after the start of the first curtailment period via a storage transfer. There is nothing preventing Users successfully claiming compensation for this gas, which may already have been subject to a successful claim by a previous owner.

Please let me know if you, or the SME assigned to this Proposal, require any further information to enable preparation of the Final Modification Report.

Yours sincerely

Ritchard Hewitt