

Draft Modification Report
Revised DN Interruption Arrangements
Modification Reference Number 0090
Version 1.0

This Draft Modification Report is made pursuant to Rule 8.9 of the Modification Rules and follows the format required under Rule 9.6.

1. The Modification Proposal

The Proposal, as revised following discussions at the Development Work Group, was as follows:

“This Proposal seeks to introduce revised DN Interruption arrangements that would allow DN Operators (DNs) to determine the quantity of interruption they require on their networks and allow Users more flexibility to request their preferred interruptible terms.

Proposed Business Rules are attached to this Proposal but essentially the key features of the Proposal, which relate solely to DN connected Supply Points, are:

- 1.1 The revised Interruptible Capacity arrangements described in this Proposal will not supersede the established Emergency Arrangements described in Section Q of the UNC.
- 1.2 The existing Firm LDZ Capacity booking arrangements will not be changed.
- 1.3 The existing UNC arrangements for requesting a switch from Interruptible to Firm will continue to apply outside the Interruptible Application Process described in this document.
- 1.4 Arrangements for requesting a switch from Firm to Interruptible will only be via the Interruptible Application Process.
- 1.5 Applications for Interruptible LDZ Capacity and management of Interruption will continue on an individual Supply Point basis.
- 1.6 Users will be able to apply for Interruptible LDZ Capacity through the Interruptible Application Process in respect of all relevant Supply Points and CSEPs with an AQ greater than 5,860,000 kWh, both Firm and Interruptible.
- 1.7 Annual applications for Interruptible LDZ Capacity will occur each year, at least three (3) Gas Years ahead of the applicable Gas Year, for example June 2007 for the Gas Year starting October 2010.
- 1.8 DN's may be permitted to tender for Interruptible rights in timescales shorter than three (3) Gas Years through the ad hoc Interruptible Application Process.
- 1.9 Users will be able to register Interruptible LDZ Capacity through the annual Interruptible Application Process for multiple Gas Years, up to and including five (5).
- 1.10 Users will be able to apply for “n” maximum Days of Interruption for each Supply Point per annum.

- 1.11 Each Transporter will publish its Interruption requirements on a location by location basis and offer Interruptible LDZ Capacity based on a range of maximum Interruptible Days, say five (5), fifteen (15), thirty (30) and forty five (45) Days. Compensation payments for Interruptible rights would be dependent on the permitted number of Days of Interruption per annum and location.
- 1.12 Interruption payments by DNs to Users will be based on an option and exercise scheme where the option fee will be a monthly payment and the exercise fee will be payable for each Day that Interruption was incurred. The charging methodology will be described in a statement provided by each Transporter in a form approved by the Authority.
- 1.13 The Transporter will be permitted to reject an application for Interruptible LDZ Capacity if the application was not required to maintain its required transportation capability.
- 1.14 A User at a New Supply Point, that is New after the Interruptible Application Process has begun, will be Firm if the LDZ Capacity is available; otherwise, the Supply Point will be allocated the required number of Interruptible Days to maintain the Transporter's required transportation capability and will receive the associated compensation payment, as set out in the Transporter's relevant statement.
- 1.15 The User can then enter the next available Interruptible Application Process to obtain revised terms although the required number of Interruptible Days will apply until the revised terms take effect.
- 1.16 All Users will pay Firm LDZ Capacity charges (from 2010) and those Users that obtain Interruptible LDZ Capacity will receive a compensation payment for Interruptible rights as set out in the Transporter's relevant statement.
- 1.17 There will not be a facility for Users to enter into Interruptible Partnering Arrangements (ref UNC Section G6.1.3).
- 1.18 The classification of Network Sensitive Loads (NSLs) and Transporter Nominated Interruptibles (TNIs) will no longer apply.
- 1.19 Section I5 of the Offtake Arrangements Document relating to Interruption for NTS purposes will no longer apply.
- 1.20 Users applying for Interruptible LDZ Capacity will be able to retain a portion of their Supply Point Capacity as Firm, subject to a minimum Interruption quantity of 5,860,000 kWh.
- 1.21 For the period from the implementation date of the Proposal to 30 September 2010, "**the Transition Period**", transitional arrangements will apply. For Interruptible Supply Points, the present Interruptible arrangements will continue to apply, e.g. forty five (45) Day Interruption Allowance, attracting the level of discount on capacity charges as set out in the Relevant Transporters' Transportation Statements."

SME Comment: Please note that for the avoidance of doubt the proposal relates to DN Connected Supply Points and DN connected CSEPs and not NTS connected Supply Points or NTS connected CSEPs.

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

1(a) the efficient and economical operation of the pipe-line system

This relevant objective was not expected to be impacted. The way in which Supply Points could become Interruptible and the terms of Interruption may change, but operation of the pipe-line system would be unaffected.

1(b) so far as is consistent with (a), the co-ordinated, efficient and economical operation of (i) the combined pipe-line system, and/or (ii) the pipe-line system of one or more other relevant gas transporter.

This relevant objective was not expected to be impacted. However, this Proposal has the support of all the DNs. By implementing this Proposal through the UNC, similar arrangements would apply in each DN, and this would avoid inappropriate and unnecessary fragmentation.

The Work Group reviewed this Proposal in the light of current NTS Capacity booking arrangements and also in the light of Modification Proposal 0116 "Reform of the NTS Offtake Arrangements". The Work Group was concerned that simultaneous implementation of the NTS Exit regime and this Proposal might increase various risks for the industry as a whole.

1(c) so far as is consistent with sub-paragraphs (a) and (b), the efficient discharge of the licensee's obligations under this licence

Implementation of this Proposal is consistent with the efficient discharge of the licensee's obligations with respect to reviewing the way in which DN Capacity is booked and paid for.

In the Proposer's view, *"this Proposal takes account of developments in the transportation business."*

The Proposer suggested that, *"implementation would enable DNs to determine the quantity of Interruption that they require to meet their 1-in-20 licence obligation and Users to indicate their preferred terms of Interruption. This would allow the DNs to make informed decisions about investment in their networks"*. Hence implementation would facilitate the discharge of licence obligations with respect to the economic and efficient development of DN systems.

Whilst it was acknowledged that implementation of this Proposal may provide an opportunity for the value of Interruption to be revealed, it was also recognised that the market response may be limited such that the value may not in fact be revealed. The existence of limited competition in Interruptible services could mean that, if a tender approach were adopted, offers in some locations may not represent an economic valuation of customers' opportunity costs and the incentivised DN response might be to invest beyond the truly economic level.

Equally, some were concerned that the potential costs of developing processes to actively value and offer interruption services to the DNs may exceed the perceived benefits. With limited participation, investment beyond the economically efficient level might be incentivised. Failure to attract interest in Interruption may require increased investment, which could in turn lead to an increase in costs to consumers.

1(d) so far as is consistent with sub-paragraphs (a) to (c) the securing of effective competition:

(i) between relevant Shippers

The Proposer suggested that, *“implementation would facilitate the securing of effective competition between Shippers by allowing Shippers to bid for the Interruptible rights for their Supply Points.”* However, Shipper and Consumer Work Group members did not share this view.

Some Work Group members believed that lack of transparency of Interruptible terms might inhibit the transfer of Supply Points, giving the incumbent Shipper a competitive advantage. The view of the Consumer representatives was that such terms should be disclosed only if the customer consented, as this would potentially reveal confidential terms between Shipper/supplier and customer. It was recognised, therefore, that individual consumers could manage this impact through their own decisions with respect to revealing information to potential suppliers.

Work Group members also suggested that the additional cost and risk burden associated with implementing this Proposal could discourage Shippers from actively competing in this segment of the market, and would discourage market entry. Hence, implementation could be expected to diminish competition between relevant Shippers and between relevant suppliers.

(ii) between relevant suppliers;

The Work Group believed that the comments detailed above in respect to competition between relevant Shippers applied equally to suppliers.

and/or

(iii) between DN operators (who have entered into transportation arrangements with relevant gas Transporters) and relevant shippers.

It was suggested that implementation may reveal information about different approaches to managing Interruption by each DN, thereby providing increased comparative regulation.

1(e) so far as is consistent with sub-paragraphs (a) to (d), 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;

The Work Group did not believe this relevant objective would be impacted were the Proposal to be implemented.

1(f) so far as is consistent with sub-paragraphs (a) to (e), the promotion of efficiency in the implementation and administration of...the uniform network code.

The Work Group did not believe this relevant objective would be impacted were the Proposal to be implemented.

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

The Proposer did not *“believe this Proposal, if implemented, would adversely impact security of supply, operation of the Total System, or industry fragmentation.”* By implementing the Proposal through the UNC, common arrangements would be provided in each DN, avoiding inappropriate and unnecessary industry fragmentation.

The Work Group recognised that if implementation led to a reduction in Interruptible quantities available at Stage 1, there would be more rapid progress to Stages 2 and 3 of a Network Gas Supply Emergency.

Some of the Shipper and Work Group members stated they also believed that implementation would increase the probability of proceeding to Stage 4.

4. The implications for Transporters and each Transporter of implementing the Modification Proposal, including

a) implications for operation of the System:

The Proposer did not *“believe this Proposal, if implemented, would adversely affect the operation of the System.”*

b) development and capital cost and operating cost implications:

No estimates were available to the Work Group with respect to either the initial cost of implementation or the continuing operating costs. Some increases were expected as the arrangements would be more complex than existing arrangements, increasing administration costs with more choice and discretion open to Shippers and DNs. However, simplification of some of the existing processes would provide offsetting savings.

Notwithstanding this, the Proposer believed that, *“this Proposal, if implemented, would not have any capital cost or operating cost implications outside the Transporters’ incentive revenue.”*

The Proposer also believed that implementation of this Proposal would be expected to facilitate the efficient trade-off of capital and operating costs, providing information regarding the economic and efficient level of costs.

Stefan Leedham, a Work Group member, commented that at this stage *“it is not clear how the pricing arrangements will work, and therefore how information will be provided about the efficient and economic level of costs, in fact it could be argued that under the ‘administered’ prices no cost information will be revealed.”*

c) extent to which it is appropriate to recover the costs, and proposal for the most appropriate way to recover the costs:

In the Proposer’s view, *“any additional costs would be recovered through application of the Transporters charging methodology.”* It was accepted that any change to the level of costs recovered – whether higher or lower – should be managed through the established price control processes. It was also recognised that additional cost recovery mechanism may be developed in light of the incentive schemes being developed outside, but associated with, the Proposal.

d) analysis of the consequences (if any) this proposal would have on price regulation:

Changes to DN charging methodologies would be needed to support implementation, and new mechanisms may be introduced to recover incentive

costs. More locational and temporal variation of effective transportation charges is anticipated.

The Work Group suggested that revenue correction mechanisms may become increasingly necessary to deal with uncertainty about both allowed and collected revenue with increased reliance on tenders and incentives.

5. The consequence of implementing the Modification Proposal on the level of contractual risk of each Transporter under the Code as modified by the Modification Proposal

The Proposer believed that, *“implementation of the Proposal would reduce the contractual risk, to which the DNs would be exposed, by allowing the DNs the opportunity to determine the volume of Interruptible rights they require. The NTS Transporter should not be affected by this Proposal.”* Not all Work Group members accepted this view and believed the risk to DNs would increase. Julie Cox, a Work Group member, believed this would be due to the DNs more clearly identifying their Interruption requirements. She believed that the risk *“would increase if DN’s forecasts turned out to be wrong and they underestimated their interruptible requirement”*

Stefan Leedham believed that the National Grid NTS would be affected by implementation. He pointed out that under the current regime *“the NTS Transporter has access to DN Interruption to manage the system; however it is not clear at the present time whether the NTS Transporter will have access to this service in the future. It would therefore appear that the NTS Transporter will be impacted by this proposal and if it is unable to access the same level of DN Interruption (if any) then it is also likely that their contractual risk will increase.”*

6. The high level indication of the areas of the UK Link System likely to be affected, together with the development implications and other implications for the UK Link Systems and related computer systems of each Transporter and Users

The Proposer was of the opinion that, *“there may be some changes required to the UK Link System if this Proposal were to be implemented. The Systems most likely to be impacted are the Sites and Meters database for recording sites with Interruptible status, SC2004 for the exercise of interruptible contracts and Invoicing 95 for payment in respect of Interruptible rights. A new system may also be required for selecting those Supply Points that are required for Interruption and this might be dependent on each DN’s selection (pricing) methodology.”*

Whilst related computer systems of Users will be affected by implementation, this is dependent on the precise nature of the regime that is implemented and hence no quantification of the impact was available to the Work Group.

7. The implications of implementing the Modification Proposal for Users, including administrative and operational costs and level of contractual risk

The Proposer stated, *“nothing has been brought to the attention of the Proposer to suggest that Users would incur additional costs or risks under the Uniform Network Code as a result of implementing the Proposal.”*

It was acknowledged that implementation might provide an opportunity for Users to develop innovative and flexible contracts.

Work Group members highlighted the level and duration of commitment that implementation might generate and the consequential effect on Users' risks.

Shipper and Consumer Work Group members also emphasised the additional risk to Users from extending Ratchet and CSEP Overrun charges to all sites – whether Firm or Interruptible. These members believed that the ability to exercise Interruption would entirely mitigate the Transporters' risk that such charges were designed to manage, in the context of Firm Supply Points. The Transporters responded that they wished to retain this aspect within the Proposal, as the principle was that the default status of all Supply Points would be Firm.

Other risks highlighted by Work Group members were that implementation would:

- increase both lead time and duration of User commitment to LDZ Capacity. This would, intrinsically, increase contractual risk for Users;
- introduce more complex arrangements for Users to manage over prolonged periods of time which would, in turn, lead to higher administration costs;
- blur the supplier/Shipper boundary as the Shipper might be applying for Firm Capacity or Interruption arrangements in respect of a Supply Point for which it may not hold the registration three (3) years later; and
- increase failure to Interrupt cost exposure due to the increase in charge rate.

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

If a tender option were adopted, and where DNs still require Interruption, consumers would be able to reveal and benefit from the true value of being Interruptible. However, they may be inhibited from offering Interruption if they perceived the regime to be complex or if implementation reduced what are perceived already to be small incentives to accept Interruptible status.

Julie Cox pointed out that, *“some customers would no longer have the option of interruptible status.”*

Stefan Leedham pointed out that it was not clear *“how consumers would be able to reveal the true value of interruption under an administered price scheme.”*

9. Consequences on the legislative and regulatory obligations and contractual relationships of each Transporter and each User and Non Code Party of implementing the Modification Proposal

Implementation would require establishment of new contractual arrangements between DNs and Users. These would be expected to be reflected in the contracts between Users and their customers.

The Transporter's safety case may need to be rewritten submitted and approved prior to implementation. This represents both a time constraint and a risk. The ability to demonstrate compliance with '1-in-20' and emergency requirements would be necessary.

10. Analysis of any advantages or disadvantages of implementation of the Modification Proposal

Advantages

It was the Proposer's belief that, *"implementation of this Proposal:*

- *would enable DN Interruption Reform to proceed in a timely fashion*
- *would enable DNs to determine the volume of Interruption they require*
- *would enable Users flexibility in the Interruption allowance they require*
- *would provide DNs with the appropriate market signals to invest in their networks."*

In addition, the Work Group suggested the following advantage:

- More equitable treatment of all Users.

Disadvantages

In the Proposer's view, *"the DNs do not believe there any disadvantages of the Proposal although some participants may argue with the timing of the Proposal if they believe that DN Interruption Reform should be linked to the timescales for NTS Exit Capacity Reform."*

In addition, the Work Group highlighted the following:

- the potential for customer's stranded assets – particularly alternative fuel storage;
- may have a knock-on effect on electricity balancing since CCGTs may be discouraged from operating flexibly; and
- less Interruptible Capacity available at Stage 1 of a Network Gas Supply Emergency.

In addition, Stefan Leedham suggested the following additional disadvantages:

- *"Long lead time may reduce the incentive for consumers and/or shippers to enter into tenders for interruption.*
- *Negative impacts on competition between shippers and/or suppliers due to the additional costs and risks associated with the implementation of this proposal*
- *Implementation timescales means that there will be fundamental reform of NTS Exit and DN Interruption at the same time, and it is not clear how these two reforms will interact and operate in the future. There is therefore significant implementation risks associated with this proposal."*

11. Summary of representations received (to the extent that the import of those representations are not reflected elsewhere in the Modification Report)

Written Representations are now sought in respect of this Draft Report

12. The extent to which the implementation is required to enable each Transporter to facilitate compliance with safety or other legislation

No such requirement has been established.

13. The extent to which the implementation is required having regard to any proposed change in the methodology established under paragraph 5 of

Condition A4 or the statement furnished by each Transporter under paragraph 1 of Condition 4 of the Transporter's Licence

Whilst implementation of this Proposal is not required to reflect any current change in the methodology, the Work Group acknowledged that such changes would form part of the total regime.

14. Programme for works required as a consequence of implementing the Modification Proposal

The Work Group identified changes at a high level to processes and systems for both DNs and Users.

15. Proposed implementation timetable (including timetable for any necessary information systems changes)

The Proposer suggested adoption of the following timetable following completion of the Work Group process:

Modification Panel agree consultation timetable	19/10/2006
DMR issued for consultation	06/11/2006
Close out of representations (15 days)	27/11/2006
FMR issued to Joint Office (15 days)	18/12/2006
Modification Panel decide upon recommendation	18/01/2007
Ofgem decision expected	31/01/2007

The Work Group emphasised the importance of all linked consultation periods being aligned in order to allow considered responses and consideration of the proposed changes 'in the round'. It therefore requests the consultation timetable takes account of this.

16. Implications of implementing this Modification Proposal upon existing Code Standards of Service

No implications were identified.

17. Recommendation regarding implementation of this Modification Proposal and the number of votes of the Modification Panel

18. Transporter's Proposal

19. Text

The two legal text documents relating to this Proposal have been loaded and published on the Joint Office web site.

Representations are now sought in respect of this Draft Report and prior to the Transporters finalising the Report

Subject Matter Expert sign off:

I confirm that I have prepared this modification report in accordance with the Modification Rules.

Signature:

Date :

Signed for and on behalf of Relevant Gas Transporters:

Tim Davis
Chief Executive Joint Office of Gas Transporters

Signature:

Date :