

Modification Report
Revised DN Interruption Arrangements
Modification Reference Number 0090

Version 4.0

This Modification Report is made pursuant to Rule 9.3.1 of the Modification Rules and follows the format required under Rule 9.4

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 15 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."

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 had 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.

EDF stated that *if all NSLs were to go firm, this could have an impact on the system.*

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.

NG NTS was concerned that implementation could also require increased investment in the NTS.

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. In its response, AEP pointed out that variations might emerge in DNs’ Interruptible Capacity Methodology statements.

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. In its response, NG NTS pointed out two related effects – an increase in the time lag in curtailing offtake at sites that have changed from interruptible to firm, and an increased number of sites protected by the monitors.

Some of the responses also indicated that implementation would increase the probability of proceeding to Stage 4. E.ON made reference to the interruption event in the summer of 2003 as an occurrence where interruption was required irrespective of the transportation infrastructure.

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.”*

In its response, NG NTS considered that implementation could restrict the options open to the NEC in the event of a Stage 1 Emergency.

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.”* NG NTS, however believed that implementation could have implications for the NTS due to higher levels of firm DN bookings being reflected in NTS capacity requirements.

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.”*

In its response, BGT was concerned that, in the event of a limited tender response, three years lead time for investment in network development may not be sufficient to provide the required capacity.

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 mechanisms may be developed in light of the incentive schemes being developed outside, but associated with, the Proposal.

In its response, GDF pointed out that no recovery of costs is proposed for at least 3 years after contracts have been finalised, and suggested it is unreasonable that shippers and consumers should face a cash-flow burden on behalf of DNs.

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.

In its response, BGT emphasised the cost uncertainty due to DNs being distressed buyers for interruptible services then passing these costs on in charges.

NG NTS observed that it would expect to be allowed to recover additional investment costs through the TO revenue element of its price control.

SGN noted interactions with NTS Offtake reform and identified some remaining issues in respect of investment lead time and capacity booking windows.

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.”*

In its response, NG NTS argued that the level of contractual risk that it faced may be impacted through the potential increase to NTS investment costs and, in some circumstances, insufficient lead-time.

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.

Whilst an impact on Users’ systems was recognised in some of the responses, this was not quantified.

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.

A further risk identified in its response by TGP was that of additional costs for an incoming User where a Supply Point had become interruptible under the existing or previous User.

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.”*

In its response, E.ON suggested that the viability of CHP plant could be impacted if a change of status from interruptible to firm resulted from implementation. Concerns in respect of alternative fuel provision were also stated in other responses with RWE pointing out that restrictions within the PPC permits might reduce applications for interruptible contracts thereby leading to decommissioning of alternative fuel facilities. CRN identified, in this context, forthcoming changes to environmental regulations.

CIA was uncertain whether unsuccessful tenderers in respect of existing interruptible sites become firm automatically or would an economic test apply. CRN identified an additional risk to a current or subsequent supplier if an interruptible consumer had become unable to meet its obligations.

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 identified by the Work Group, supported in some subsequent responses were as follows:

- DN Interruption Reform enabled to proceed in a timely fashion
- DNs enabled to determine the volume of Interruption they require
- Users' flexibility enabled in the Interruption allowance they require
- DNs provided with the appropriate market signals to invest in their networks.
- More equitable treatment of all Users.
- Current interruptible customers who wish to go firm would be able to do so without being constrained by the economic test.
- DN charges might fall if DNs secure their interruption more cheaply than
- Shorter term tender process would allow for discrete interruptible requirements to be satisfied.
- All Users would be treated equitably.

Disadvantages identified by the Work Group and additions from subsequent responses were as follows:

- 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;
- Less Interruptible Capacity available at Stage 1 of a Network Gas Supply Emergency.
- 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.
- Customers will no longer be able to choose between firm or interruptible transportation, with the decision largely made by the DN.
- If participation is limited DNs may have to invest in their networks, and DN charges may therefore rise.
- Increase in Safety Monitor storage requirement.
- Increase in NTS investment costs that are not likely to be captured by the current price control review.
- The inability to predict whether sufficient interruption will be offered or at what price.

- Information from Ofgem’s Impact Assessment will not be available prior to completion of the UNC consultation process.

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

Representations were received from the following 19 parties, of which 1 was in full support, 5 offered qualified support, 2 offered comments, 1 confirmed a neutral position, and 10 were not in support:

Organisation	Abbreviation	Position
National Grid Gas plc	NG UKD	Supports
E.ON UK	E.ON	Not in Support
Corus	COR	Not in Support
Association of Electricity Producers	AEP	Not in Support
Chemical Industries Association	CIA	Not in Support
Corona Energy	CRN	Not in Support
Statoil UK	STUK	Not in Support
Scottish & Southern Energy	SSE	Not in Support
Scotia Gas Networks	SGN	Not in Support
EDF Energy	EDF	Not in Support
Total Gas & Power	TGP	Not in Support
National Emergency Co-ordinator	NEC	Comments
Gaz de France	GDF	Comments
British Gas Trading	BGT	Qualified Support
National Grid NTS	NG NTS	Qualified Support
Northern Gas Networks	NGN	Qualified Support
Wales & West Utilities	WWU	Qualified Support
RWE Npower	RWE	Qualified Support
Energywatch		Neutral

CRN commented that there is “no evidence to suggest that Ofgem is well placed to independently determine what is a reasonable level of interruption, or what are reasonable levels of costs to manage constraints. Incentives which rely on such outputs are unlikely to achieve the objectives which underpin their existence.”

NG NTS made the point that, with regard to the interaction of the NTS Exit and the DN Interruption reform proposals, it considered that, *“the timing of the auction or tender processes in each Modification Proposal should also be carefully timed, such that the results of the DN Interruption tenders are able to inform the NTS Exit (Flat) Capacity auctions. It is therefore important that any changes that impact on the timing of these processes in either of the Modification Proposals is considered in light of their consequential impact on the other Proposal. Furthermore, should any changes to investment lead times be implemented, as discussed in Ofgem’s Draft Licence Modifications document (“Transmission Price Control Review: Draft Licence Modifications” ref 197/06, dated 15 November 2006), these will also need to be reflected in the processes for both of the above Modification Proposals.”*

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 has suggested approval by 31/01/2007 in order to meet the date identified for the first tenders,

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

At the Modification Panel meeting held on 21 December 2006, of the 10 Voting Members present, capable of casting 10 votes, 5 votes were cast in favour of implementing this Modification Proposal. Therefore, the Panel did not recommend implementation of this Proposal.

18. Transporter's Proposal

This Modification Report contains the Transporter's proposal to modify the Code and the Transporter now seeks direction from the Gas & Electricity Markets Authority in accordance with this report.

19. Text

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

For and on behalf of Relevant Gas Transporters:

Tim Davis

Chief Executive Joint Office of Gas Transporters