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6<sup>th</sup> December 2006

**Re: Modification Proposals 0116V/0116VD/0116A/0116BV/0116CV: “Reform of the NTS Offtake Arrangements”**

Dear Julian,

This response is on behalf of RWE Npower plc and the UK business of RWE Trading GmbH, collectively referred to below as RWE.

RWE does not support the implementation of this Modification Proposals 0116V

RWE does not support the implementation of this Modification Proposals 0116VD

RWE supports the implementation of this Modification Proposals 0116A

RWE offers qualified support for the implementation of this Modification Proposals 0116BV

RWE offers qualified support for the implementation of this Modification Proposals 0116CV

Amongst these proposals, we would rank our support for them in the following order: (most supported first) 0116A, 0116C, 0116B, 0116D, 0116. Our support for 0116CV is qualified on the basis that if, and only if, 0116A is judged not to better facilitate the relevant objectives would we support 0116CV. Our support for 0116BV is qualified on the basis that if, and only if, 0116A and 0116CV are judged not to better facilitate the relevant objectives would we support 0116BV.

Modification proposals 116V, 116A, 116BV, 116 CV and 116VD include detailed descriptions of the nature of the proposals, how they may better facilitate the relevant objectives, what the system implications of their implementation may be and the advantages and disadvantages that may arise from them. Such arguments are well rehearsed and clearly described in the draft modification report so we have not sought to replicate these verbatim in our response below.

Only where we disagree with an argument put forward in support of a particular modification proposal(s), or where we feel there is the need to expand on

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arguments, or provide different perspectives, have we made comments. The fact we have chosen not to comment on all the arguments made against the criteria below is a recognition of the fact that we believe an argument to be valid regardless of whether we support the modification (or offer qualified support) or not.

This approach has been taken in order to avoid producing an overly long response which repeats arguments that are adequately described in the draft modification proposal. With this in mind our comments are as follows.

## **1. Extent to which implementation of the proposed modification would better facilitate the relevant objectives**

### *Gas Transporter Licence Standard Special Condition A11.1*

(a) *the efficient and economic operation of the pipe-line system to which this licence relates;*

#### 0116A

- No compelling evidence has been presented to suggest that the current arrangements direct connects and DNOs use to book NTS Exit Capacity are inherently inefficient or uneconomic. Also instances of asset stranding and customers opting for interruptible contracts once physical capacity has been commissioned have been rare.
- The current administered processes of booking NTS Exit Capacity through the Offtake Arrangements, UNC registration and ARCA arrangements remain appropriate recognising the different offtake characteristics of DNOs and direct connects and the licence/market framework within which they each operate.

#### 0116BV & 0116CV

- These modification proposals recognise that investment by NG NTS in new NTS Exit Capacity and the investment by Users in offtaking infrastructure is not something that can be easily shoehorned into a rigid capacity allocation timetable based around NG NTS's notional default investment lead time. Whilst incremental NTS (Flat) Exit Capacity allocation needs to dovetail with any incentive arrangements and licence obligation NG NTS will operate under, unlike 0116V these modification proposals recognise the need for NG NTS to be bound by a reasonable endeavours obligation to make capacity available within shorter than default lead times, where possible, and for periods commencing other than the start of the gas year. NG NTS have suggested in 0116V that a further modification proposal may need to be raised following conclusion of the Transmission Price Control Review which includes "the potential ability to apply for an increase in Prevailing NTS Exit (Flat) capacity commencing from a date earlier than that implied by the default investment lead time". Equally it may be that a follow up modification proposal is needed to address this in the event 116BV or 116CV were to be implemented. Crucially however, 0116BV and 0116CV require NG NTS to be reasonably obliged to do this where it is possible, for example where no, or minimal, investment/reinforcement is required. This encourages more co-ordinated and efficient investment decisions by both NG NTS and Users, leading to more economic and efficient operation of the system

#### 0116V, 0116BV and 0116VD

- The introduction of a flexibility product will not allow NG NTS to undertake better informed investment decisions, thereby facilitating the efficient and economic operation of the system, indeed the opposite

may be the case. NG NTS have previously stated that they have made not made any investments to date to provide flexibility (as it is a by product of flat capacity investment) and that they do not intend to do so in future, therefore no meaningful investment signals can arise.

Direct connect Users will have no clear idea how much flexibility they are likely to need outside the immediate short term. This could lead them to overbook based on their maximum perceived requirement (providing this can be secured at reasonable cost), or to acquire capacity in the short run through their OPN submissions. Neither of these possibilities will result in any greater system efficiency compared to the current arrangements.

The amount of flexibility available on any day is dependent on a large number of factors that are variable from day to day and difficult to predict in the long term. Because of this, the amount of flexibility NG NTS claims it can make available by way of a baseline is far less than that which is likely to be available on most days. Despite this, Users use of flexibility is not likely to be coincident and so this should still sufficient to satisfy the combined gas flows off all Users.

Due to the uncertainty direct connect Users have in predicting their long term requirements and the licence obligations DNOs have to acquire sufficient flexibility under their safety case, should all Users attempt to book sufficient flexibility to meet their maximum flow rate variation the baseline will be exceeded. In such circumstances a false price and perception of scarcity could arise.

Those parties that acquired long-term flexibility may be reluctant to make unused flexibility available, or transfer it to another User, until such time as they were sure that it would not be needed. This might also create false constraints on the system.

- (b) *so far as is consistent with sub-paragraph (a), the coordinated, 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 transporters;*

#### 116V and 116VD

- The proposals contend that “the proposed commercial regime should enable NG NTS to better respond to its Exit Capacity incentive by optimising the provision of Exit Capacity at high times of high demand by efficiently trading off pipeline investment against buyback contracts”. To the extent this is true it can only be applicable in the case of flat capacity, bearing in mind NG NTS do not intend to make any investment in flexibility capacity, the flexibility will be set at a conservative level and that on a large number of days flexibility well in excess of the baseline (zonal, area or maximum) is likely to be available.

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

#### 0116V, 116BV and 0116VD

- We do not accept that the arrangements contained within these modification proposals will necessarily avoid unfair or unduly discriminatory arrangements as is claimed. Requiring all Users to follow a common set of arrangements for booking both flat and flexibility capacity does not in itself mean that as a result unfairness and/or discrimination are avoided (although 0116BV recognises this may be the case in relation to flat capacity).

Like the proposer of modification proposal 0116A, we believe that the various classes of User are not materially comparable and that there are valid reasons for their different treatment. As such different treatment is appropriate.

NG NTS may argue that such arrangements are necessary to prevent any unfairness and/or discrimination occurring in future. However, as far as we are aware there has been no instances of discrimination and/or unfairness occurring in the allocation of flat or flexibility capacity over the 18 months since DN sales occurred, since when DNOs and direct connect Users have been operating

under different allocation arrangements. Nor it would appear, based on baseline analysis presented by NG NTS and offtake bookings by DNOs, is there any likelihood of any significant physical shortfall in flexibility arising in the short to medium term.

These proposals appear to us to be a disproportionate reaction to a potential problem that might never occur. We believe that in the short to medium term NG NTS's licence obligation not to discriminate in the services it provides to offtaking Users is sufficient to prevent any undue discrimination or unfairness in how NG NTS allows Users to offtake gas from the system.

Even if the risks are greater than we perceive, they are still not sufficient to justify the degree of extra operational complexity 0116V, 0116DV and (to a lesser extent) 0116BV will introduce into Users day to day gas flow management processes and systems. Recognising the existence of the current flexibility product and monitoring its use, such that the extent of any current or future discrimination can be understood and visible to all Users (as proposed by 0116CV), would seem to be a pragmatic step if it is considered necessary to disaggregate flat and flexibility capacity for all Users.

- Although these modification proposals are based on common arrangements for all Users there are still other areas where unfairness and/or discrimination may be introduced. Discrimination and/or unfairness (intentionally or otherwise) may result from how NG NTS set the baseline for flexibility capacity and in how they allocate this to zones/areas. This process is likely to remain a largely opaque to Users even if they are required to produce a methodology describing it. Flexibility allocation at Shared Supply Meter Points and bi-directional flows may also cause unfairness in the event an agent is not appointed to centrally acquire flexibility on behalf of all Users at that NTS Exit Point, which NG NTS cannot mandate.

#### 0116BV

- This modification proposal seeks to lessen the extent of any unfairness and/or discrimination arising from introducing common arrangements for all Users by:
    - increasing the overall tolerance to take account of Users entitlement to vary hourly flows as stated in the NExAs/Connection Agreements/UNC and not exposing them to flexibility overruns in the event they remain within these restrictions;
    - ensuring the full amount of flexibility is made available by reducing the flexibility capacity allocated by way of an OPN submission (but not by way of an auction) when an OPN re-submission indicates less flexibility will be used;
    - preventing the introduction of a non cost reflective flexibility commodity charge;
    - charging flexibility overruns only on days where a scarcity exists;
    - providing Users relief from overrun charges where they are incurred as a result of intertrips or forced outages which Users have little direct control over;
    - targetting neutrality costs and revenues more accurately to Users who are most directly impacted; and
    - requiring NG NTS to publish within day information regarding flexibility capacity usage to all Users on a regular basis, such that they have the necessary information to assess the extent to which they face being exposed to constraints or overruns.
- (d) *so far as is consistent with sub-paragraphs (a) to (c) the securing of effective competition:*
- (i) *between relevant shippers;*
  - (ii) *between relevant suppliers; and/or*
  - (iii) *between DN operators (who have entered into transportation arrangements with other relevant gas transporters) and relevant shippers;*

## 0116V, 0116VD

- Common arrangements will not in themselves secure effective competition between shippers, suppliers and/or DNOs if parties are not in a position to compete fairly for the products because of the different market and regulatory frameworks they operate under. A DNO, which has licence and safety case obligations associated with its capacity holdings, will have different incentives to acquire flexibility capacity (particularly in the long term) compared to a direct connect User. DNOs may attribute a higher value to flexibility as result of these obligations compared to direct connect Users, and have a greater ability to pass on costs they incur in acquiring capacity.
- The operational complexity that will arise from implementation of either of these proposals will disadvantage all shippers/suppliers, but will disadvantage small shippers/suppliers disproportionately. It would be no surprise if certain shippers/suppliers withdrew from supplying NTS connected end users as a result and/or if new entrant shippers/suppliers avoid competing in this market sector. Any competition benefits that are perceived to arise from common arrangements need to be weighed against this.

## 0116BV

- Despite proposing the introduction of common arrangements this modification proposal does not claim that these will in themselves secure effective competition (unlike 0116V and 0116VD). The modification proposal contains the following measures designed to allow Users to passively manage their flexibility capacity requirements and use without unduly increasing the risk of flexibility overrun charges.
  - Increasing the overall tolerance to take account of Users entitlement to vary hourly flows as stated in the NExAs/Connection Agreements/UNC and not exposing them to flexibility overruns in the event they remain within these restrictions;
  - Ensuring the full amount of flexibility is made available by reducing the flexibility capacity allocated by way of an OPN submission (but not by way of an auction) when an OPN re-submission indicates less flexibility will be used;
  - Preventing the introduction of a non cost reflective flexibility commodity charge;
  - Charging flexibility overruns only on days where a scarcity exists;
  - Providing Users relief from overrun charges where they are incurred as a result of intertrips or forced outages which Users have little direct control over
  - Targetting neutrality costs and revenues more accurately to Users who are most directly impacted; and
  - Requiring NG NTS to publish within day information regarding flexibility usage to all Users on a regular basis, such that they have the necessary information to assess the extent to which they face being exposed to constraints or overruns.

As a result Users may be able to avoid costly system investment, or avoid employing extra resource to manage real time flexibility usage. For example, the above measures may persuade Users that whilst they need to be able to access details of their hourly offtake within day, they do not need to build functionality that takes this captured hourly offtake information and converts it into an actual and forecast flexibility usage figure. They may also not need to employ resource to monitor this up to 22:00 hrs. Instead the User may be persuaded that because of these measures the likelihood of artificial constraints developing, or overrun exposure, is less than under 0116V and 0116VD. On this basis they may feel they can manage these risks on the few occasions they arise using manual processes and spreadsheets. Similarly, if a User knows there will be no flexibility commodity charge written into the UNC, they will not have to invest in capturing and storing hourly flow data and the resultant flexibility usage which would otherwise be necessary to validate (either manually or automatically) and challenge flexibility commodity invoices.

(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 (within the meaning of paragraph 4 of standard condition 32A (Security of Supply – Domestic Customers) of the standard conditions of Gas Suppliers’ licences) are satisfied as respects the availability of gas to their domestic customers; and*

- No additional comments to those included within the draft modification proposal

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

- No additional comments to those included within the draft modification proposal

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

### 0116BV and 0116CV

- We support the comments made against these modification proposals and believe they are valid counter arguments as to why the two benefits claimed in 0116V and 0116VD may not have any positive impact on security of gas supply.  
Bearing in mind that instances of NG NTS rejecting OPNs have been extremely rare, and that the maximum coincident use of flexibility capacity by all Users is less than the notional baseline, we would not expect NG NTS's new flexibility buyback system management tool to be used regularly. It is unlikely therefore to provide any material benefit in terms of efficient system management.

### 0116V, 0116BV and 0116VD

- Whilst not a relevant objective of the UNC we believe that these modifications could have an adverse impact on electricity security of supply by restricting the ability of gas fired power stations to operate in the balancing market.

## **3. The implications for Transporters and each Transporter of implementing the Modification Proposal, including**

### **a) implications for operation of the System:**

#### 0116BV and 0116CV

- Information about flexibility capacity availability and utilisation (on a national, are and zonal basis) will need to be readily available to NG NTS's Control Room staff in the event modification proposals 0116V or 0116DV are to be implemented. This is because NGG NTS will need to assess whether the OPN submissions/re-submissions of Users who have not bought flexibility capacity in advance can be accepted, or whether a Flexibility Constraint Day needs to be called.  
Modification proposals 0116V and 0116VD have not sought to make this information available to all Users. This may be because of the complexity and expense involved in developing a robust process for transferring the hourly changing flexibility utilisation/availability from NG NTS's operational systems onto Gemini or NGG NTS's website.

Ofgem, in their decision document on modification proposal 006, recognised that in order for markets to operate efficiently it is important that the arrangements in place are as transparent as possible. This is particularly so in this case of a new flexibility capacity market, as Users have very little idea

currently of how much flexibility capacity is used on a day to day basis by other Users, or the occasions on which it is likely to be used by the various classes of User. In the absence of such knowledge, Users are unable to determine the real value of flexibility capacity and the risks that may, or may not, arise from the decisions they make to acquire their flexibility requirement.

Mod 116BV and Mod 116CV address these concerns by requiring NGG NTS to publish data which is readily available to them to the wider market. The fact that this may require them to spend money which they cannot recover from shippers should not detract from the fact that such information is necessary to bring a base level of efficiency to an already complicated new market.

**b) development and capital cost and operating cost implications:**

- No additional comments to those included within the draft modification proposal

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

- No additional comments to those included within the draft modification proposal

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

- No additional comments to those included within the draft modification proposal

**4. 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**

- No additional comments to those included within the draft modification proposal

**5. 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**

0116BV

- See comments above under section 1.d

0116BV and 0116CV

- See comments above under section 3.a

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

0116V, 0116BV and 0116VD

- Each of these modification proposals, if implemented, creates the risk that a User's flat capacity (acquired via the long term allocation window and/or the annual constrained auctions) and flexibility capacity may become stranded, for example if the end user customer goes out of business. As a User commitment is required for each of these acquisitions, this may require Users to introduce more stringent credit arrangements.

There is also a risk that flat and flexibility capacity acquired in such a manner may not be transferred or assigned efficiently between shippers in the event of a change of supplier. Incoming shippers may be able to commercially disadvantage outgoing shippers by leaving them holding capacity they do

not require, for example by buying capacity in the short term knowing it cannot be used by the outgoing shipper.

#### 0116CV

- This modification has the same potential risks as described immediately above in relation to 0116V, 0116BV and 0116VD, but only as regards flat capacity.

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

#### 0116V, 0116BV and 0116VD

- These modification proposals will significantly impact the contractual arrangements between shippers and suppliers/end user customers where supply is to an NTS connected facility. We do not believe that end user customers are sufficiently aware or prepared for such changes. Nor do we believe they have undertaken any analysis of the longer term changes they may have to make to systems and processes in order to operate their plant under the arrangements contained in these proposals.

#### 0116CV

- This modification has the same potential impact as described immediately above in relation to 0116V, 0116BV and 0116VD, but only as regards flat capacity. Suppliers and end user customers will be far more able to manage the impact of changes to the enduring flat capacity allocation process compared to the introduction of flexibility capacity and its allocation

### **8. 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**

- No additional comments to those included within the draft modification proposal

### **9. Analysis of any advantages or disadvantages of implementation of the Modification Proposal**

#### **a) We have identified the following advantages:**

#### 0116V and 0116VD

- We do not accept that these modification proposals provide a "better fit of NTS Exit Capacity arrangements under a divested industry structure that exists following the sale of a number of distribution networks in 2005" as claimed.  
NGG NTS have provided no evidence, either formally or anecdotally, of any changes in User behaviour or any increased risk to the operation of the system over the last 18 months. During this time Users have continued operating as they have done for many years, albeit under transitional arrangements bought in at the time of DN sales. Similarly no compelling evidence has been presented to suggest this will not remain the case.  
NG NTS's reason for raising this modification proposal, is in our opinion, a reaction to the Authority's previous insistence that NG NTS agree to conditional special licence condition A55 as a condition of DN sales. This required NGG NTS (and other transporters) to use best endeavours to introduce the enduring offtake arrangements in a form approved in writing by the Authority, which at the time was acknowledged to be the "TANIF" model. Although the Authority have stated they no longer intend to enforce this condition as currently drafted, Ofgem's letter<sup>1</sup> announcing this did state that Authority

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<sup>1</sup> Letter from Alistair Buchanan dated 26/6/05 entitled "Enduring Offtake Arrangements" - Ref 151/05



would give consideration to replacing or modifying this licence condition to require NGG NTS to implement enduring offtakes from September 2007. Whilst these current modification proposals are different to the "TANIF" model the core proposal to disaggregate flat and flexibility remains, and the design of the flexibility capacity product remains unchanged. This is despite fears of discrimination and unfairness during the transition period proving to be unfounded and despite recent suggestions by a DNO<sup>2</sup> that the flexibility capacity product derived from the "TANIF" model may not be fit for purpose.

- We do not accept that these modification proposals provide certainty to Users by confirming capacity holdings well in advance of gas flow.  
Whilst any incremental flat prevailing capacity Users may require will be confirmed well in advance of the date it is to be made available, there is no guarantee Users will be able to physically flow gas against it as it may not have been built. Whilst this may be more of an issue for NG NTS's licence and incentive scheme, these modifications facilitate the buy back of flat and flexibility capacity that would be used in such circumstances.  
Also, any User who is not able to reliably forecast their use of flexibility capacity in advance, and therefore is reliant on acquiring flexibility capacity through submission of OPNs, may not have their holding confirmed until within the gas day itself if it needs to vary its OPN due to changes in operating circumstances.

**b) We have identified the following disadvantages:**

- No additional comments to those included within the draft modification proposal

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

- No additional comments to those included within the draft modification proposal

**11. 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**

- No additional comments to those included within the draft modification proposal

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

0116V, 0116BV, 0116CV and 0116VD

- In the event any of these modification proposals are approved it needs to be recognised that changes will be required to both Users and NG NTS's processes and systems. As such, a programme of works needs to be drawn up that properly recognises the time required by Users to make such changes, and contingency needs to be built in to allow for unavoidable slippage that may arise.

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<sup>2</sup> Draft Modification Proposal "Change of Definition of Flow Flexibility Capacity" V1.0 raised by NG Gas Distribution - dated 23/11/06

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

0116V and 0116VD

- The proposed implementation timetable may be achievable, but if not consideration should be given to compressing the long term flat and flexibility capacity allocation lead times. This is unlikely to be an issue for flexibility capacity, as no investment is expected to arise from the auction results and baselines have been fixed for 2010 and beyond.

0116BV and 0116CV

- In addition to the comments regarding 0116V and 0116VD above, we believe that information regarding the availability and utilisation of flexibility capacity may be able to be made available on Gemini prior to the commencement of the first long term flexibility capacity auctions. This may require NG NTS to insist that Users submit OPNs electronically, which we would not be opposed to if it enables this timetable to be met.  
Provision of such information in advance is, in our opinion, a pre-requisite to commencing any long term flexibility capacity auction.

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

- No additional comments to those included within the draft modification proposal

**15. Further Comments**

- No additional comments to make

Yours faithfully,

Steve Rose  
Economic Regulation  
Sent by e-mail and therefore unsigned