National Grid Transco

NGT House
Warwick Technology Park
Gallows Hill, Warwick
CV34 6DA

T +44 (0)1926 653000
F +44 (0)1926 654378
www.ngtgroup.com

Sonia Brown
Director, Transportation
Office of Gas and Electricity Markets
9 Millbank
London
SW1P 3GE

Chris Train
Director – Network Sales

chris.train@ngtuk.com
Direct tel +44 (0)1926 655667
Direct fax +44 (0)1926 656563

28 July 2004

Dear Sonia

Interruptions Arrangements Regulatory Impact Assessment - NGT Response

We welcome the opportunity to comment on this Regulatory Impact Assessment, which considers options for reforming the current interruption arrangements. This response outlines our views on:

- Evaluation of the need for change
- Safe operation
- Options for NTS interruption
- Options for DN interruption; and
- Options for constrained and unconstrained primary capacity allocation

This response describes how we envisage interruption arrangements could be developed should the case for reform be agreed through this consultation process.

Evaluation of need for change

We support the case for taking forward reform to the NTS interruption arrangements, recognising this as a gateway requirement to allow the network sales to proceed. This would involve the development of market-based solutions for the allocation of firm NTS exit rights, supported by turndown contracts and the short-term release of interruptible exit capacity. This would effectively contractualise NTS access to interruptible loads on the DNs, and alleviate concerns over the potential for undue discrimination between users of the NTS.

However, we believe that further work is required to justify reform of the DN interruption arrangements. Whilst we would agree that the proposed reforms have some underlying economic rational, the practical reality may be very different. For example, any operational benefits identified may be offset in the short-term by increased costs of contracting for interruption in areas where capacity is in short supply and there is limited competition for the provision of interruption services. Also, any capital investment efficiencies could be offset by the need for investment to deal with a limited supply of cost-effective interruption services in such areas. More critically, many current interruptible users connected to the DNs who favour the simplicity of the current arrangements may decline to offer interruptible services in order to avoid the cost and complexity this would entail. To the extent this occurs, DNs would need to invest in their networks in order to deal with any such reduction in interruption services available to them.

Any benefits could also be offset if reform to the DN interruption arrangements required the introduction of market based solutions and systems for booking DN exit capacity, particularly if this also impacted on IT systems for DN charging and supplier switching. Such systems are large and complex, dealing with millions of supply points, and as such, the cost and timescales associated with their replacement/modification my be prohibitive. Accordingly, whilst it is clear that the proposed reforms will impose incremental cost and complexity on shippers and GTs, we believe that further work is required to demonstrate the benefits these reforms will deliver to consumers.

Our overriding concern, which we believe is one shared by the industry, is that the proposed reforms to the DN arrangements represent a large, complex solution to a relatively small problem. It would seem sensible and more cost effective to design a solution proportionate to the problem. We believe that the present arrangements offer a practical compromise for a service that delivers benefits for consumers whilst not creating significant distortions in efficiencies for different categories of customer or for Transco's operations. Ofgem have previously introduced a per event payment through our incentives for each day of interruption (above a 15-day threshold) as a solution to perceived inefficiencies in constraint management. We believe that further adaptations of these pricing/incentive arrangements could be explored for the DNs with a view to providing a proportionate solution to the concerns discussed in this RIA.

Safe operation

Interruption reform needs to be considered in the context of our obligation to maintain and operate a safe and secure pipeline system and in this context we would expect that significant reforms would require ratification by the Health and Safety Executive and an accepted change to our GT Safety Case. In particular, we consider that reform should:

- provide confidence in the ongoing provision of network capability to meet contracted demand up to the current 1 in 20 pipeline security standard;
- provide an efficient means of giving access to demand management, when required; and
- be consistent with HSE requirements.

On the first issue, we would have concerns about any proposal that meant shippers were able to make "take it or leave it" offers to the network operators in a timeframe that left little or no room for the operator to secure the necessary capacity through alternative means (be it through investment or re-tendering for interruption services). The large numbers of smaller interruptible sites within DNs are less likely to respond to a tender process than the relatively larger interruptible sites on the NTS. Our concern is heightened because we would have no prior knowledge of how many customers would wish to remain on interruptible terms or how many days of interruption exposure they are likely to choose. This issue therefore needs careful consideration as part of developing the proposals to ensure that safe system operation can be maintained at all times.

With regard to the second safety issue, any interruption reform, particularly in the context of disposal, should continue to enable demand management to be enacted in a timely and efficient manner when required. We believe that an operator-to-operator relationship is best suited to enabling the TSO to call for interruption that might be sourced from within a DN.

Finally, the new arrangements will need to be satisfactory to the HSE when it considers the appropriateness of any proposals and their potential impacts upon emergency procedures and GT safety cases.

Options for NTS Interruption

If Ofgem and the Authority conclude that reform to the NTS interruption arrangements is justified in the light of our response and other respondents' views, we would support Ofgem's conclusion that developing a tender (turndown) process (Option 3B in the RIA) would be the most appropriate way forward for NTS demand management. Timescales for implementation would be contingent upon

the timescales allowed for industry consultation together with the development of business rules, legal drafting and supporting systems.

We interpret this option as one involving the development of a market-based solution for the allocation of firm NTS exit rights. This would be supported by tenders for demand turndown to manage the level of firm capacity commitments, and the short-term release of interruptible exit capacity for customers who wish to take an interruptible service. Appendix 1 provides a table of the NTS services that we envisage under this option.

We believe that there is general agreement in the industry that enabling NTS to contract directly with consumers for demand management services would be desirable. Tenders for turndown have in part been developed as a vehicle enabling that to happen. However, in order to deliver a suitable contractual framework for contracting with consumers it is our opinion that an exemption would be required from the provisions of the Gas Act that requires a Gas Transporter to restrict any contracts that it may enter into for the conveyance or offtake of gas to being with shippers only. If the Act is not changed or an exemption is not granted then turndown arrangements would be limited to use by shippers only. As a consequence, some of the perceived benefits of turndown may be lost.

We believe that the critical “interruption issue” that is created by potential disposal of networks is whether operators would have access to demand management in respect of other networks and if so what contractual framework would apply. We consider it appropriate that the Transmission operator should continue to have access to demand management associated with load connected within a Distribution Network. In our opinion, establishing an operator to operator relationship, either through the Offtake Code or by other contractual means such as the turndown concept, would best enable the TSO to have access to DN (via the DNO) interruption.

Provisions to meet the requirements of the European Gas directive have been included in the recent Energy Bill. The accompanying draft regulation on “conditions for access to the gas transmission networks” is in the final stages of discussion before becoming directly applicable in the UK, which is expected to be during 2006. Draft articles 4 and 5 of the regulation both refer to Transmission System Operators being required to offer interruptible access rights and we therefore believe that a solution should be developed that continues to enable interruptible access rights to be released by the TSO. We believe that the proposed solution is compatible with this requirement but would necessitate the removal of the “universal firm” obligation from Special Condition 28(6)(c) of our Gas Transporters licence.

At present there are 21 sites with interruptible contracts on the NTS. We consider that the cost of developing both a tender and a matrix process (Options 2C or 3C) for use on the Transmission system is not justified by the potential benefits of operating both processes for a small number of sites. Our preliminary indications are that a turndown solution could cost around £1m and an application process would cost around £2m. Consequently we do not consider that the scale of the perceived problem warrants the costs of developing both a turn down and a matrix process for use on the Transmission network.

Options for DN Interruption

Reform to DN interruption arrangements is a far more fundamental issue, representing a major change to the current arrangements, and introducing new costs and complexities on GTs, shippers and consumers. Accordingly, we believe that reform on this scale needs further consideration. . Given that DN interruption reform is not directly linked to network sales, we suggest that this is de-linked from the network sales process and considered separately so that a thorough exploration of the issues can be undertaken with the industry, thus allowing proportionate solutions to be identified.

We are conscious that the matrix type solution has been developed in response to customers’ suggestions that any revised solutions should remain relatively simple and that a range of administered terms for interruption would best serve this objective. In general, we support this

argument and consider that undue complexity or risk could drive a flight from interruption to firm terms for no other reason than to manage increasing uncertainties.

It is conceivable that shippers could be willing to offer certain large supply points into a tender arrangement for DN interruption and as such we consider that a mixture of market and administered price arrangements (Option 3C) might be beneficial. This in effect would be a tender for demand management services to be used around three years ahead and an administered price matrix of interruptible terms that shippers could apply for in the months ahead of the relevant gas year. However, we believe that the majority of DN interruption would be contracted through the matrix process and as such the costs of multiple interruption arrangements should be considered against the scale of benefits that might be realised.

Interruption has a use for the transporter in enabling demand management to overcome constraints and in certain cases supply demand deficits. However, it also serves an important function for shippers and consumers and we believe that consideration should be given to the effect on their businesses of any changes that may be developed. For example, Shared Supply Meter Points have been developed, not to assist transporters, but to facilitate retail competition by enabling a consumer to contract with more than one gas supplier and to be able to frequently switch between the contracts that he has available to draw upon. We believe that it is prudent to consider whether removal of interruptible transportation services in all instances except where the transporter requires it will facilitate wider objectives such as facilitating competition in gas supply and other "benefits" the present service might deliver to consumers.

Options for constrained and unconstrained primary capacity allocation.

We agree with Ofgem's conclusion in its cost benefit analysis that a constrained primary capacity release process is the appropriate way forward for the NTS (Option 3 in the RIA). In practice, we consider that this feature has a stronger relationship to the proposed developments discussed in Ofgem's recent Offtake Arrangements Regulatory Impact Assessment.

In our view, the release of primary NTS exit capacity could be developed along similar lines to the present NTS entry capacity arrangements. That is to say, the release of NTS exit capacity could be provided on an unconstrained basis in a timeframe that is consistent with our ability to provide additional infrastructure should that be required. In this model, it might be appropriate for exit capacity to be considered for release against the requirements set out in an NPV test that is designed to validate that the NTS does not make uneconomic decisions.

Capacity offered for release within a timeframe for which investment could not normally be made would be considered against obligations on the NTS to release no less than a pre-set baseline. It is conceivable that an incentive could be developed to encourage the NTS to consider releasing more than the baseline provision, and offset this against additional turndown contracts if it is economic to do so. (For clarity we have provided a pictorial example of this scenario in Appendix 1).

We do not consider that the mix of constrained and unconstrained capacity release described above can readily be transferred to DN exit capacity arrangements where the potential for obtaining a longer-term investment signal is, in our opinion, extremely limited. We also consider that the existing arrangements are well suited to enabling retail competition to flourish because the present arrangements are expressly designed to enable capacity to be allocated to whichever shipper is registered as the holder of supply point capacity during its tenure.

Similarly we consider that an unconstrained allocation model for DNs would need further development before its merits could realistically be assessed. Our initial thoughts on this approach are that it is not practical for domestic and small industrial consumers to be expected to offer to surrender transportation capacity, and as such any reforms would need to distinguish between large and small consumers. Any buy-back arrangements would need to be carefully designed to avoid market power issues and to prevent increased costs being passed to wider system users.

We also believe that development of a long term capacity booking process within DNs would also require a fundamental redesign of the underlying IT infrastructure at a probable level of expense that would not appear to be warranted by the scale of the perceived problems. On this point there is no business definition available to enable us to provide a meaningful assessment of the potential impacts.

Conclusion

If the Authority conclude that reform to the NTS interruption arrangements is justified in the light of our responses to the RIA, we would support the case for taking forward reform to the NTS interruption arrangements under Option 3B, recognising this as a gateway requirement to allow the network sales to proceed. Timescales for implementation would be contingent upon the timescales allowed for industry consultation together with the development of business rules, legal drafting and supporting systems.

For the DNs, we believe that the present arrangements offer a practical, cost effective compromise for a service that delivers benefits for consumers whilst not creating significant distortions in efficiencies for different categories of customer or for Transco's operations. In giving further consideration to DN interruption reform, we suggest that this is a substantial issue in its own right, and should be de-linked from the networks sales process so that a thorough exploration of the issues can be undertaken with the industry and proportionate solutions can be identified.

I hope that you find this response helpful.

Yours sincerely

By E-Mail

Chris Train

Appendix 1

Table 1

Product	Period				Availability
	On the day	Day ahead	Up to 3-years ahead	Greater than 3-years ahead	
Firm	Yes	Yes	Yes		Constrained
Firm				Yes	Un-constrained
Interruption		Yes			Un-constrained
Tenders for firm turn down		Yes	Yes	Yes	Subject to NTS requirement

Table 2