



Gas Distribution Network Sales Interruptions arrangements: Decision document

Contents

1. Allocation alternatives: options, RIA responses and conclusions
2. Interruptions contracting: options, RIA responses and conclusions
3. Transitional arrangements
4. Summary of proposed arrangements

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Allocation alternatives for exit capacity

Three alternatives for allocation of access to the network within network owner's investment lead time:

- **Status quo**
 - capacity rights available at administered prices
 - Users allocated capacity on first come first served basis
- **Unconstrained**
 - all who want capacity receive it at administered prices
 - to meet demand, NTS buys-back capacity rights
- **Constrained**
 - fixed amount of capacity made available that reflects physical capacity of the network
 - rationed on basis of willingness to pay

Allocation alternatives for exit capacity

RIA options

Option 1

- Status quo (first come first served)
- Customers elect whether to be interruptible



RIA Summaries

- Lowest cost to implement
- Potential for undue discrimination
- Lack of investment signals
- Risk of stranded assets

Option 2

- Unconstrained allocation
- NTS buys-back rights to ensure supply of NTS exit capacity = demand



- No undue discrimination between firm & interruptible customers
- Freedom to contract
- Competition benefits
- Risk of stranded assets

Option 3

- Constrained allocation
- “Use it or lose it” mechanism used to stop hoarding of rights



- Improves incentives to book long-term capacity relative to Option 2
- Many of other benefits of Option 2

Summary of RIA responses

Option 1

- Preferred by 12 out of 13 who expressed an opinion
- In addition, proposed by NGT for DN interruptions
- Wholesale reform not required as part of DN sales
- No cross-subsidies as claimed by Ofgem

Option 2

- Preferred by 1 out of 13 who expressed an opinion
- Greater customer choice
- More cost-reflective
- Efficient operating decisions

6 preferring Option 1 acknowledged some benefits of Option 2

Option 3

- Proposed by NGT for the NTS
- Not the preferred option of any other respondent mainly due DN application concerns.
- No investment signals
- Complexity / costs may discourage participation
- No customer support

4 respondents did not state a preferred option but expressed concern over the need for fundamental reform as part of DN sales

Authority's conclusions

NTS level

- Reform of NTS arrangements a “gateway” requirement
- Adopt Transco's proposal of constrained allocation (Option 3) at NTS level

DN level

- Given respondents views, the Authority considers it inappropriate to reform DN arrangements as part of DN sales
- Retain status quo (Option 1) at DN level in short term
- Impose a condition to ensure that DN interruptions regime issues resolved by 2006

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Options for interruptions contracting

Two basic alternatives for contracting for interruption:

- **“Matrix” approach**
 - menu of different combinations of “price” and “maximum number of days interrupted” offered to customers in a standard form
 - preferred combination selected by customers
 - Network owner selects those interruptible contracts it requires
- **“Tender” approach**
 - customers offer network owner interruption contracts setting out the price and days combination they favour
 - network owner selects most economic offers to manage each bottleneck

... and variations / combinations of these are possible

Options for interruptions contracting

RIA options

Option A – Pure matrix

- Customers choose price / no. of days combination from published matrix



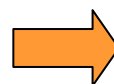
Option A* - Simplified pure matrix

- Customers choose no. of days from published matrix



Option B – Tenders

- Customers tender to provide interruptible services



Option C – Tenders plus matrix

- Customers can choose to tender or pick from the matrix published



RIA Summaries

- Simple approach
- Less accurate signals provided

- Simplest approach
- Little or no signals provided

- May discourage participation
- Detailed signals provided

- Potential for matrix to distort tenders
- Detailed signals provided

Summary of RIA responses

Option A – Pure matrix	8 out of 9 that expressed an opinion, believed some form of matrix approach was most appropriate.
Option A* – Simplified pure matrix	<ul style="list-style-type: none"> Simple Encourages participation Least cost 5 expressed a preference for Option A*, 1 for Option A
Option B – Tenders	NGT proposed a tender approach on the NTS One other respondent saw benefits in Option B or Option C.
Option C – Tenders plus matrix	<ul style="list-style-type: none"> Provide more information More operating choice Option C encourages participation more than Option B

NGT acknowledged a matrix approach might be appropriate in the event of DN exit reform

Authority's conclusions

NTS level

- Given adoption of Option 3 at NTS level, Ofgem considers a tender approach to contracting most appropriate
- This is NGT's favoured approach

DN level

- Given respondents views, the Authority considers it inappropriate to reform DN arrangements as part of DN sales
- Retain status quo (Option 1) at DN level in short term
- Impose a condition to ensure that DN interruptions regime issues resolved by 2006
- The Authority favoured a matrix approach for enduring arrangements at the DN level

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Transitional arrangements

Two key issues:

■ **Distributional concerns**

- Some customers who are currently interruptible may not be required to be interruptible in the future
- These customers will lose their discount on exit capacity charges, and may be left with stranded assets (e.g. gas storage facilities)

■ **Market power concerns**

- Some critical supply points may only have one customer
- NTS may be forced to pay artificially high prices to secure interruption at these points

Transitional arrangements

RIA proposals

To address distributional concerns

- “Glide-path” proposed to give current interruptible customers a soft landing



Summary of responses

- Five respondents argued that transitional arrangements were necessary to manage distributional concerns
- One expressed a preference for a glide-path approach

To address market power issues

- Price cap proposed to prevent abuse of market power at certain key sites



- Three respondents emphasised the importance of addressing the market power issue through a price cap or alternative mechanism
- Two respondents were against a price cap

Authority's conclusions

- No transitional arrangements proposed as part of this process, as only NTS will be reformed in the short term
- Implementation of change at the DN level not until 2006

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Summary of proposed arrangements

- NTS level
 - Long term – unconstrained allocation
 - Medium and short term - constrained allocation
 - Very short term – Interruptions product to be sold by Transco NTS
 - Buy-backs of NTS capacity should be on a tender basis
- DN level
 - status quo retained in short term
 - reform implemented by 2006 (matrix approach) – not linked to DN Sales timescales
- No transitional arrangements