Shippers, Transco and other interested parties

Bringing choice and value to customers

Our Ref: Net/Cod/Mod/635
Direct Dial: 020 7901 7389
Email: steve.smith@ofgem.gov.uk

1 October 2004

Dear Colleague

Network code modification proposal 0635 "Changes in Gas Supply Emergency Arrangements"

Ofgem[1] has carefully considered the issues raised in modification proposal 0635 to Transco's network code, "Changes in Gas Supply Emergency Arrangements".

Ofgem has decided not to direct Transco to implement modification proposal 0635 because Ofgem does not consider that the proposal will better facilitate the relevant objectives of Transco's network code under standard condition 9 of Transco's Gas Transporters (GT) licence.

In this letter, Ofgem explains the background to the modification proposal and gives reasons for making its decision.

Background to the proposal

Current gas supply emergency arrangements

Transco, as Network Emergency Co-ordinator (NEC)[2], has specified a Safety Case (approved by the Health and Safety Executive (HSE)), which sets out its procedures to deal with a gas supply emergency. The NEC Safety Case, in conjunction with the Gas Safety (Management) Regulations (GS(M)R) (1996), details the arrangements for co-ordinating the actions to be taken to prevent a supply emergency occurring or continuing. It includes an assessment of network risk and identifies two situations that would result in a Network Gas Supply Emergency (NGSE). The first is where there are insufficient gas supplies available to the National Transmission

[1] Ofgem is the office of the Gas and Electricity Authority. The terms 'Ofgem' and the 'Authority' are used interchangeably in this letter.
[2] The named role for the NEC is the Director of Operations and Trading of Transco.

System (NTS). The second is where there is a critical transportation constraint in either the NTS or in a local distribution zone (LDZ).

When Transco identifies a supply shortfall that is unable to be addressed through the normal commercial arrangements, it will ask the NEC to declare an emergency situation. The NEC would then invoke all or part of the following five-step procedure as appropriate:

- **Stage 1 – notice of impending emergency**. This indicates that there is a potential gas emergency, where the information available to the NEC at Stage 1 indicates that there is sufficient time, and sufficient gas available, for the primary system to be rebalanced without recourse to Stage 2. This would include maximising the use of linepack, storage and interruption;

- **Stage 2 – declaration of emergency**. At this stage the On-the-Day Commodity Market (OCM) is suspended and the primary transporter is instructed to carry out the measures set out in the emergency arrangements. After the OCM has been suspended, a new cash out price needs to be established. Under the current provisions of Transco's network code, the existing dual cash out price is replaced by a single price[3]. Currently this is calculated as the average of the System Average Price (SAP) for the 30 days immediately preceding the suspension of the OCM. The rationale for this cash out price is that it represents a neutral price, which would not expose shippers to excessive windfalls or losses. In any event, any shipper that believes it has suffered costs over and above this 30 day SAP is able to submit a claim for such costs;

- **Stage 3 – firm load shedding**. The affected transporter makes direct or indirect contact with firm end-users and instructs them to stop or reduce their offtakes of gas. Firm load shedding is divided into three tranches of increasing severity and effect. The three tranches are:

    - very large end-users (VLDMC) (those taking more than 50 mtpa)
    - large end-users (those taking between 25,000 tpa and 50 mtpa)
    - end-users taking less than 25,000 tpa

  Firm load shedding will be invoked in the order shown above. It is at Stage 3 that flows through the interconnectors can be curtailed;

- **Stage 4 – system isolation**. The available gas would be allocated to secondary systems supplying domestic end-users;

- **Stage 5 – restoration**. Normal arrangements are restored.

The actions that Transco and the NEC would take are set out in the NEC Safety Case.

Appropriateness of the current arrangements

There has been much debate over recent years, as to whether the current emergency arrangements in the gas industry remain appropriate. This debate has, to a large extent, taken place in the Gas Industry Emergency Committee (GIEC), a body chaired by Transco and attended by the Department for Trade and Industry (DTI) and gas industry representatives, and which was constituted to consider emergency arrangements for the gas industry. The GIEC has now been

[3] Network Code, section Q, paragraph 4.2.

replaced by the Gas and Electricity Industry Emergency Committee (GEIEC) in order to reflect the need to consider the increased interactions between the gas and electricity markets.

In the past the GIEC and other interested parties have been of the opinion that the ongoing appropriateness of the current arrangements should be given consideration. The areas for consideration included:

- that having a neutral emergency cash out price may not encourage gas onto the system prior to the declaration of an emergency at Stage 2;

- that having a neutral emergency cash out price may not encourage customers to reduce gas demand. There are three aspects to this point. First, firm customers who are exposed to prices in the commodity market will, when the price of gas is high enough, reduce consumption. Second, customers could be offered compensation for exceptional interruption by shippers. Third, although shippers to larger firm customers are required to have arrangements in place to ensure that they can stop using gas in an emergency situation, tests have in the past revealed that these arrangements are in a poor state; and

- potentially giving perverse incentives to large shippers who, in a situation of being very short of gas, could force the gas systems into an emergency situation when the prevailing OCM price is higher than the 30 day average SAP calculation and thereby avoiding exposure to the high price.

These concerns have resulted in previous modification proposals to Transco's network code, which were raised to try to rectify the perceived problems with the prevailing emergency arrangements.

Previous modification proposals

> *Network code modification proposal 0294 "Change to cash-out following an emergency"*

Modification proposal 0294 was raised by Transco in November 1998. This proposal sought to revise the methodology for calculating the cash out price during a network gas supply emergency from being a 30 day average SAP to being 2 x 30 day average SAP. Ofgem rejected this proposal in December 1999 on the basis that the methodology appeared to be arbitrary with the implication that the price derived could be too high or too low. In rejecting this modification proposal, Ofgem acknowledged that concerns remained about the appropriateness of the current cash-out price in an emergency and highlighted that it may be appropriate for the industry to continue considering the issue.

> *Network code modification proposal 0502 "Changes to Commercial Arrangements in the Event of a Gas Supply Emergency" and network code modification proposal 0568 "Changes to Commercial Arrangements in the Event of a Network Gas Supply Emergency"*

Modification proposal 0502 was raised by Transco in November 2001. This proposal sought to differentiate between two types of gas supply emergencies. First, a gas deficit emergency (GDE), where inadequate gas supplies leads to a national shortfall and, second, a transportation failure emergency, where sufficient gas supplies are available to the system but due to a critical transportation constraint it is not possible to meet all demand in a particular area.

With these two definitions of gas supply emergencies, the cash out price would be:

- 2 x 30 day average SAP for a GDE; and

- 0.75 x 30 day average SAP for a transportation failure emergency.

Modification proposal 0568 was raised by Transco in July 2002. This proposal also differentiated between two different types of gas supply emergency, a GDE and a critical transportation constraint emergency (CTCE) but proposed that the resulting cash out prices would be:

- 2 x 30 day average SAP for a GDE; and

- normal cash out arrangements prevailing with respect to a CTCE.

The overall rationale for the increase in cash out prices under the relevant emergency circumstances in both proposals was that it would encourage more gas onto the system in the run-up to an emergency and that it would incentivise shippers to put in place arrangements with firm customers to shed their load.

Ofgem rejected both proposals on the basis that it did not consider the proposed methodology for calculating cash out would necessarily encourage more gas onto the system once a supply emergency had occurred. Ofgem, in its decision letter, highlighted that an insufficient amount of work had been done on the interactions between the gas and electricity markets. Finally, in preparation for winter 2002/03, NGC and Transco did not identify emergency arrangements as being an issue that will impact on the safe operation of the gas and electricity systems for that winter.

Network code modification proposal 0582 "Changes to Commercial Arrangements for a Network Gas Supply Emergency"

Transco subsequently raised network code modification 0582, to which Ofgem granted urgent status in September 2002. This proposal again distinguished between a GDE and a CTCE. For a GDE the OCM would still be suspended and shippers would get cashed out at 30 day average SAP. For a CTCE, the commercial system and user balancing arrangements such as OCM trading would continue to apply throughout the emergency.

On 20 September 2002, Ofgem approved this modification proposal but stated in its decision letter that it did not consider that any further changes should be made to the current emergency arrangements in terms of the calculation of any applicable cash out price until further work was carried out. Ofgem also considered that insufficient work had been undertaken on the interactions between the gas and electricity markets.

Comparison to the electricity industry

In the electricity industry, there are, to some extent, similar arrangements. Section G of the Balancing and Settlement Code (BSC) outlines the balancing and settlement arrangements that can be invoked in emergency situations. In these circumstances (after consultation with Ofgem), the Secretary of State may activate changes to the balancing and settlement arrangements including:

- specifying that a single cash out price be determined to reflect the price of bulk electricity in the relevant settlement period. This price can refer to reported prices and price indices (i.e. the price is intended to reflect the "market price for bulk electricity"); and/or

- limiting the prices for bids and offers to historic values.

Alongside Section G of the BSC, the Fuel Security Code allows for the provision of compensation to generators. Compensation will be given if the Secretary of State determines that a generator has suffered exceptional loss in carrying out instructions issued via direction(s) given by the Secretary of State under Section 34 or 35 of the Electricity Act 1989 in relation to fuel security event, and the Secretary of State determines that it is acceptable for the generator to receive compensation.

The modification proposal

Modification proposal 0635 was proposed by Transco on 13 June 2003. This modification proposal seeks to amend the current arrangements relating to a GDE as follows:

- during Stage 2 of a GDE, at which the NEC would be seeking to maximise gas supplies at one or more System Entry Points, the NEC would have discretion as to whether Transco would retain the option of using the Trading System for system balancing purposes on that day. If this were the case, the cash out price calculation would remain unchanged. The claims review process would not apply if the normal commercial arrangements were not suspended; and

- in the event that the NEC did proceed to Stage 3 of a GDE, normal commercial arrangements would be suspended and the 30 day average SAP would apply.

Respondents' views

There were 12 responses to the modification proposal. Of these, four were in favour of the modification proposal, one offered qualified support and seven did not support the modification proposal.

Of the respondents not in favour of this modification proposal, several stated that they did not consider that keeping the OCM open in Stage 2 whilst also having the command and control arrangements in operation would help facilitate a market response to the emergency. One respondent considered that where shippers are ordered to maximise flows by the NEC, Transco would have no reason to purchase this gas via the OCM as it would know that the gas would be delivered regardless. With this in mind, one respondent was concerned that shippers following the NEC's orders would receive a vastly inferior price for their gas than a shipper selling on the OCM, thus shippers with beach gas could become distressed sellers.

Another respondent who opposed the modification proposal considered that if the NEC had discretion over suspending the OCM, there must be some upper limit to which Transco may accept bids and offers on the OCM, dictated potentially by the highest priced gas available to them, for example LNG. The respondent considered that otherwise there would be no incentive on Transco to stop taking bids and offers irrespective of the price and whether or not the gas will actually be delivered.

Several respondents noted that they supported the principle of maximising demand side participation and therefore facilitating a market response via the OCM. However it was deemed that this modification proposal would not facilitate this. It was suggested by a respondent that an extra stage could be inserted between two and three. Whereby at Stage 2, the emergency has

The Office of Gas and Electricity Markets 9 Millbank London SW1P 3GE **Tel** 020 7901 7000 **Fax** 020 7901 7066 **www.ofgem.gov.uk**

been declared but the OCM remains in operation without the command and control aspects and Stage 2 would therefore become Stage 3. Two of the respondents considered that market participants would be best incentivised when market rules remain in place, but this modification proposal in itself would not better facilitate a market response.

It was also considered by a number of respondents that allowing the NEC to have discretion over whether the OCM should remain open or be suspended would add confusion to the emergency arrangements and in an emergency the arrangements should be set against clear criteria. It was also stated that because the NEC can decide which steps of the emergency arrangements to initiate and the length of time for which these steps are in place, further confusion could be created.

Two respondents also expressed concerns that if this modification proposal was implemented, it would not work alongside the recently agreed arrangements between the industry, Ofgem, DTI and Transco. These arrangements describe the process that leads to the NEC suspending the OCM and the DTI issuing directions to field operators and partners to maximise production. On this basis a couple of respondents did not consider that an increase in production could possibly send out market signals that would have a positive effect on interconnector imports or load shedding. Any increase in supply would dampen the price signals. One respondent however did acknowledge that more demand side flexibility would be offered in Stage 2 than in Stage 1 as the probability of firm load shedding increases. However, this respondent considered that any response would be limited on the basis that it would be unlikely that shippers would modify their supply contracts.

One respondent also stated that in Stage 2 when an emergency had already been declared, the probability of moving to Stage 3 would be considerably higher, which would result in administered cash out prices. This would provide adverse incentives on shippers to offer gas that is already flowing, as the shipper would rather be cashed out at the 30 day average SAP in Stage 3 thereby accelerating the emergency to Stage 3. In relation to this, the respondent also considered that basing cash out prices on 30 day average SAP would be too low to encourage the correct behaviour from shippers and believed it should be two or three times the current arrangements.

Several respondents also stated that they did not consider this modification proposal to have the intended effect on the interconnector. It was suggested that the ability of the interconnector to provide the additional flexibility needed would be constrained by contractual agreements, inability to secure flexible balancing tools, and the potential to be exposed to significant imbalance charge.

The respondents supporting the modification proposal stated that they considered that giving the NEC discretion as to when the OCM should be suspended would allow for greater flexibility when dealing with a GDE. In a GDE, prices would be rising and this would encourage shippers to contract with customers to negotiate turn downs and also provide incentives for shippers to offer all the available gas to the system. Extending the period that the OCM remains open into a GDE would give the market participants the chance to offer any additional flexibility. That is, by keeping the OCM open longer, exceptional market solutions not normally undertaken could be encouraged, which could resolve an emergency situation. These respondents considered that this would allow additional availability of gas at System Entry Points and reduce the likelihood of the emergency situation moving to Stage 3. However one respondent pointed out that if the market is operating effectively, there should be no need to move to Stage 2 of an emergency.

A respondent also considered that by keeping the OCM available for longer it could potentially raise the risk of high short-term cash out prices, which could incentivise shippers to balance

The Office of Gas and Electricity Markets 9 Millbank London SW1P 3GE **Tel** 020 7901 7000 **Fax** 020 7901 7066 **www.ofgem.gov.uk**

their portfolios, thus helping the overall balance of the system. Another respondent considered that if Transco and the NEC were taking prudent balancing actions then it would elicit a useful response in terms of supply and demand balancing, but the respondent did not expect that the total effect of balancing to be large given that the usual level of system imbalance is not that significant.

One respondent noted that allowing the NEC discretion over the timing of the suspension of the OCM would be beneficial because this would allow it to recognise that emergency situations differ and in some cases the market mechanism could provide the best solution. The respondent considered that this discretion would also give the NEC additional flexibility to assess and reassess the changing information.

The respondent offering qualified support stated that, in principle, a market based solution would be better than the command and control arrangements and that greater flexibility is more likely to be offered at Stage 2 than at Stage 1. However it considered that the criteria that would be used when the NEC is exercising its discretion were unclear. The respondent was also unsure how the discretion to keep the OCM open would work alongside the command and control arrangements and that any uncertainty could distort or dampen the effect of a market based solution. The respondent also noted that the effect of this modification proposal on the electricity market had not been taken into account, observing that there is a risk that a gas emergency could lead to an emergency on the electricity system.

Transco's views

Transco did not support modification proposal 0635. However, Transco noted that the continuation of the OCM would encourage more flexibility to help avert the emergency situation proceeding to Stage 3 and that it would allow the interconnector to better respond to the commercial opportunities to facilitate a resolution of the emergency situation. Transco considered that more demand side flexibility would be offered in Stage 2 over Stage 1 as the probability of firm load shedding in Stage 3 is higher, thereby facilitating a market response to the emergency. Transco also considered that this modification proposal could encourage the development of contracts that could be used to help avert Stage 3 of the emergency arrangements.

However, while Transco considered that this type of modification proposal could be beneficial, it was mindful of the potential for ambiguity between the established procedures in support of NEC 'command and control' and the continuation of market arrangements. Transco also acknowledged that a period of time should be allowed for the upstream participants to strengthen their emergency arrangements. This time period would also allow an opportunity for amendments to contracts with end-users. With these issues in mind, Transco suggested that these emergency arrangements are kept under review but it no longer supported this modification proposal.

Transco re-iterated this view in a letter to Ofgem in relation to modification proposal 0635 dated 17 June 2004. In this letter, Transco stated that it was confident that the existing mechanisms are effective and that it no longer considered that a revision such as that proposed in modification proposal 0635 would have the beneficial effect envisaged by some parties in the discussions.

The Office of Gas and Electricity Markets 9 Millbank London SW1P 3GE **Tel** 020 7901 7000 **Fax** 020 7901 7066 **www.ofgem.gov.uk**

Ofgem's view

Ofgem has carefully considered the views of all the respondents and Transco on modification proposal 0635. Ofgem considers that this modification proposal does not better facilitate achievement of the relevant objectives of Transco's network code.

Relevant objective 9(a) of the GT licence – the efficient and economic operation by the licensee of its pipe-line system

Ofgem supports the principle of giving the NEC the option to maintain the operation of market arrangements for as long as is considered appropriate in a potential emergency situation. Ofgem considers that retention of the market arrangements could provide market participants with stronger commercial incentives to seek to alleviate an emergency situation. For example, if there was a shortage of gas as the result of an emergency, it is likely that gas prices would be high. In response to the signals provided by high prices, market participants have commercial incentives to increase gas supplies (or manage demand), thereby alleviating the emergency. Ofgem also notes that the option of retaining market arrangements, and the associated commercial incentives, in order to alleviate an emergency situation, is particularly important in the context of gas flows via interconnectors, which cannot be directed under a command and control approach. Therefore, Ofgem considers that, wherever possible, it is preferable for market arrangements to be retained and used to alleviate emergency situations.

This modification proposal allows for the OCM to remain open in Stage 2 of an emergency. This would run alongside the command and control directions given by the DTI to the producers to maximise gas flows. Ofgem considers that potential emergency situations can arise for a variety of reasons and that suspending the OCM at Stage 2 may not be appropriate in all cases. For example, if there is an emergency associated with gas quality problems, it may not be appropriate to suspend the OCM. Ofgem also notes that retaining market operations could provide commercial incentives for gas flows via interconnectors in Stage 2, which could not be directed under command and control. Ofgem, therefore, considers that it may be appropriate to retain the option to allow the OCM to remain open in Stage 2 as this would allow the NEC greater flexibility when dealing with an emergency and could encourage the aversion or resolution of emergency situations via commercial mechanisms.

However, whilst generally supportive of its intention, Ofgem has not been convinced that this modification proposal would operate as anticipated, without the potential for unintended consequences in the market, including limiting additional gas flows during or before an emergency situation and the potential for detrimental interactions with the electricity market. Furthermore, Ofgem does not consider that it has been demonstrated that the impact of these potential consequences would not act to the detriment of the market and consumers. Ofgem considers that while modification proposal 0635 seeks to provide additional flexibility to the NEC when dealing with an emergency situation, it does not provide sufficient clarity as to the criteria for either retaining or suspending the OCM in Stage 2. Ofgem is of the opinion that the actual operation of the emergency arrangements in this respect must be made clearer, accompanied by defined criteria for usage, in order to avoid the potential for unintended consequences, including possible confusion between requirements to respond to command and control directions instructions and the continued operation of the market, which could prevent the delivery of additional gas onto the system. Ofgem notes that a number of respondents to Transco's consultation shared the view that the emergency arrangements should be set against clear criteria to avoid the potential for confusion. Ofgem agrees that if the NEC is to have the ability to retain the OCM, its use of this option must be in accordance with clear criteria to reduce this possibility. Furthermore, Ofgem considers that ahead of suspension of the OCM in Stage 2 as at present, it may be appropriate for there to be an additional stage which makes a

The Office of Gas and Electricity Markets 9 Millbank London SW1P 3GE **Tel** 020 7901 7000 **Fax** 020 7901 7066 **www.ofgem.gov.uk**

number of defined options, ranging between full market operation and complete command and control, available for use by the NEC with associated defined criteria for usage.

In addition, Ofgem notes that Transco did not support the implementation of modification proposal 0635 in the Final Modification report. Ofgem further notes that, in its letter of 17 June 2004, Transco reiterated this view and stated that it did not consider that modification proposal 0635 was required as it would not have the beneficial effect envisaged.

Overall, in light of the above and the views of the majority of market participants, including Transco in its role as SO, Ofgem is not able to conclude that any beneficial effects of this modification proposal would outweigh the potential for adverse, unintended consequences that may arise from its implementation. Ofgem therefore considers that due to the potential for confusion during an emergency and any unintended effects, this modification proposal does not better facilitate achievement of relevant objective (a) of Transco's network code.

Relevant objective 9(c) of the GT licence – securing of effective competition between relevant shippers and between relevant suppliers

Ofgem considers that having the option to keep the OCM open during Stage 2 of an emergency situation could facilitate competition between relevant shippers and suppliers. However, in the absence of a clearer demonstration of there being limited potential for unintended consequences in relation to how the revised emergency arrangements would actually operate, Ofgem considers that potential exists for consequences to occur which may distort effective competition. Therefore, Ofgem does not consider that this modification proposal would better facilitate relevant objective 9 (c) of Transco's network code.

Other considerations

Offshore information

Ofgem acknowledges that the introduction of the voluntary offshore information release program in November 2003 has ensured that Transco now receives better information from producers when it considers there to be difficulties on the system, prior to Stage 1 of the emergency arrangements. Under the scheme, if it is experiencing difficulties, Transco would inform the DTI, who would request a six day forecast from the offshore producers. The progression of the offshore information disclosure debate has also ensured that Transco is now receiving much better forecasts of ahead-of-day and within-day terminal gas flows and planned and unplanned maintenance, which Transco uses to help operate the system in a safe and efficient manner. These offshore information developments should help Transco to avoid an emergency situation because it is now getting earlier and more comprehensive information with which it can take action at the onset of any potential offshore problems. Ofgem notes that Transco considers that this improvement in offshore information release has increased its confidence in the effectiveness of the existing arrangements.

NGT Winter Outlook Report

In preparation for winter 2004/05, Ofgem asked National Grid Transco (NGT) whether, in its opinion, there are adequate arrangements in place to ensure system security during the coming winter. In its Winter Outlook report[4], NGT maintained that under all credible scenarios the security of gas supply could be maintained without any NGT interruption of firm gas supplies, as long as there is sufficient response from the beach, storage and the necessary increase in

[4] 'Preliminary Winter Outlook Report – 2004/05', National Grid Transco, May 2004.

The Office of Gas and Electricity Markets *9 Millbank London SW1P 3GE* ***Tel*** *020 7901 7000* ***Fax*** *020 7901 7066* ***www.ofgem.gov.uk***

demand-side response. NGT did not identify changing the emergency arrangements as being an issue that would be likely to impact on the safe operation of the gas system, or the electricity system, for this coming winter.

Way forward

It is clearly important that cash out prices create appropriate commercial incentives on shippers at all times. The current rules for calculating cash out were designed to do this. However, Ofgem is concerned that the 30-day average SAP methodology utilised during emergency arrangements may result in inappropriately benign cash out prices during such periods. Ofgem is concerned that the discontinuity created by the transition from normal cash out arrangements to 30-day average SAP in an emergency may give rise to unintended consequences and/or perverse incentives on market participants. On this basis, Ofgem is concerned that the current arrangements may not create appropriate commercial incentives on shippers in the run-up to a potential emergency situation. Ofgem has highlighted its concerns in relation to these issues in previous decision letters in the context of both the gas and electricity arrangements[5].

Ofgem welcomes the consideration given by both Transco and industry participants to these issues to date and acknowledges that the GIEC/GEIEC has been considering the appropriateness of the emergency arrangements over recent years. Ofgem acknowledges that the work of GIEC/GEIEC has focused on the practical operation of the emergency arrangements rather than on developing the commercial incentives associated with the emergency arrangements. Ofgem does not consider, however, that the work progressed within the context of the modification process has resulted in improvements in the commercial incentives associated with avoiding or managing an emergency. Therefore, Ofgem considers that, given the lack of progress made and/or consensus reached in this area to date, these issues should be addressed as a matter of priority. Ofgem is of the opinion that Transco, as SO, should consider the issues and seek to develop potential improvements to the commercial incentives associated with emergency arrangements.

In addition, Ofgem notes that consideration of the emergency cash out arrangements will be undertaken by the cash out review working group[6]. Ofgem considers that this working group could consider further the issues associated with emergency cash out arrangements raised during the modification proposal 0635, recognising Ofgem's concerns regarding the potential for unintended consequences and the interactions between gas and electricity arrangements resulting from proposed modifications in this area of the trading arrangements as highlighted in this letter. However, Ofgem notes that NGT has stated[7] that it is particularly important that cash out prices provide appropriate signals in times of energy shortage, as weakened signals could threaten the security of supply. Therefore, Ofgem considers that Transco and/or market participants should consider potential revisions to the emergency arrangements at an earlier stage given the priority attached to these issues.

---

[5] These issues are raised in the decision letters for network code modification proposals 0294, 0502, 0568 and 0582 referred to above. In the context of the electricity arrangements, similar issues are raised in the decision letters for Modification Proposals P135 ("Marginal System Buy Price During Periods of Demand Reduction") and P138 ("Contingency arrangements in relation to the implementation of Demand Control measures pursuant to Grid Code OC6").

[6] On 1 March 2004, Ofgem published a letter setting out its intention to carry out a review of cash out arrangements in the electricity and gas markets. On 17 May 2004, Ofgem published a consultation document which initiated the review of the gas and electricity cash out arrangements. On 18 August 2004, Ofgem published an open letter, establishing a working group to enable wider consideration of issues relating to both the gas and electricity cash out arrangements.

[7] See BSC Modification Proposal P135, which was proposed by NGT. While this is an electricity related modification, the point being made is equally valid to the gas arrangements.

Ofgem's decision

For the reasons outlined above, Ofgem has decided not to direct Transco to implement network code modification proposal 0635 because Ofgem does not consider that it better facilitates the achievement of the relevant objectives as outlined under standard condition 9 of Transco's GT licence.

If you have any further queries in relation to the issues raised in this letter, please feel free to contact Simon Bradbury on 020 7901 7249 or Fiona Lewis on 020 7901 7436.

Yours sincerely

Steve Smith
Managing Director, Markets

The Office of Gas and Electricity Markets *9 Millbank London SW1P 3GE* ***Tel*** *020 7901 7000* ***Fax*** *020 7901 7066* ***www.ofgem.gov.uk***