Pricing Consultation Paper PC81

Interruptible Transportation Charging

1. Introduction

Since introduction of the present interruptible transportation charge arrangement, Transco has become aware that the present mechanism by which a shipper may receive payment for occurrences of interruption greater than 15 days within a formula year may have undesired consequences in a number of areas. These arrangements came into effect from April 2002 as part of the NTS SO Incentive scheme and following consultation on interruptible charging[1].

At present, shippers to interruptible supply points avoid both NTS exit capacity and LDZ capacity transportation charges. Additionally, shippers may receive a payment from Transco for each additional day of interruption over 15 days. Transco maintains a site count of the number of days of interruption initiated by Transco, to date, this interruption has been solely for capacity constraint purposes. Interruption initiated by a shipper for commercial reasons does not qualify for this additional payment.

Shippers are responsible for gas balancing within Transco's transportation system. Transco may act from a position of residual gas balancer where, in aggregate, shippers actions result in the system being out of balance. Transco is concerned that the present interruptible transportation arrangements do not sufficiently incentivise gas consumers to enter into non-Transco called interruption arrangements with shippers / suppliers, or shippers to fulfil their primary balancing role. Where demand side interruption is not available to shippers, this could lead under certain circumstances to Transco acting in, what it considers to be, a primary balancing role.

Interaction of the PC74 methodology with shipper gas balancing responsibilities and with the intent of the NTS System Operator (SO) Exit Capacity Investment Incentive are discussed within this consultation paper.

We consider it appropriate to review the present arrangements within a system balancing climate of a tightening supply and demand position and increasing beach gas unreliability. Consequently, Transco has issued this paper with a view to amending its transportation charging methodology. We also intend to raise a Modification Proposal to the Network Code in order to address associated contractual changes. Transco intends to present the Modification Proposal to the Network Code Modification Panel on 20th May 2004. Implementation of this proposed charge methodology amendment would be dependent upon the approval of the associated Network Code Modification Proposal.

This consultation paper seeks views on the proposed change to the charging methodology such that Transco called interruption carried out for supply and demand management purposes would be excluded for the purposes of calculating any additional interruptible transportation credits that shippers would be entitled to. It is intended that this change will reduce the incentive on consumers / shippers to wait for Transco to initiate interruption where such interruption was for the purpose of managing a supply deficit.

2. Background

At present, shippers do not pay NTS exit capacity and Local Distribution Zone (LDZ) capacity transportation charges for the interruptible supply points contained within their consumer portfolio. Following consultation on PC74, Transco introduced, from April 2002, an additional transportation credit to shippers at interruptible supply points in the form of a credit for each additional day of interruption over 15 days at a supply point. The credit is calculated based on

[1] PC74 Interruptible Transportation Charges April 2002

$1/15^{th}$ of the firm annual capacity (NTS & LDZ) charge avoided and paid to shippers where Transco initiates interruption.

PC74 was intended as a transitional arrangement until an enduring NTS exit capacity regime could be developed. Payments made within the PC74 arrangement form part of Transco's costs within the NTS SO incentives under the NTS Exit Capacity Investment Incentive.

The current transportation charge arrangements do no affect Transco's right to interrupt standard interruptible supply points for up to 45 days, and more in the case on TNI's[2], within each year.

3. Summary of Proposal

A change to the transportation methodology is required in order to reduce the likelihood of Transco being required to assume a primary gas balancing role where interruption is required for supply demand balancing purposes.

It is proposed to modify the qualification by which shippers to interruptible supply points become eligible to receive credits arising from interruption beyond 15 days within a formula year[3]. Transco proposes to exclude interruption arising solely for the purposes of supply demand gas balancing from the count of qualifying interruptible days. Transco would continue to monitor the level of supply point interruption within the formula year running from 1st April to 31st March. Consequently, the supply point count of interruption would increment, as now, by one for each day of interruption where such interruption was for the purpose of managing a capacity constraint or for the purpose of testing a supply point's ability to interrupt.

Implementation is proposed for 1st October 2004 with any interruption resulting from supply demand gas balancing from that point forward being excluded from the count of qualifying interruption. The count of qualifying interruption would be used as the measure by which a supply point is deemed for payment purposes to have exceeded 15 days of interruption within a formula year. The transportation credit would continue to be equivalent to $1/15^{th}$ of the annual NTS exit capacity and LDZ capacity charges avoided as a result of the interrupted supply point having interruptible rather than firm transportation rights.

Transco would continue to have the right to interrupt standard interruptible supply points for up to 45 days, and more in the case on TNI's, within each year. For the avoidance of doubt, interruption arising for supply demand purposes would continue to be included within the standard 45 day right, and more in the case of TNI's.

Transco recognises that development and implementation of Exit Capacity Reform may result in further changes to Transco's NTS SO exit capacity investment incentive and its demand management tools. However, we believe that the changes put forward in this paper would be beneficial for the forthcoming winter and do not pre-empt the outcome of the review of Exit Capacity.

[2] TNI – A category of interruptible supply point defined within Transco's Network Code that may be interrupted on more than 45 days within any gas year.
[3] The formula year runs from 1st April to 31st March.

4. Discussion

Gas Balancing

Transco acts in a residual role to balance the gas transportation system where shippers fail to balance their individual supply portfolios. The financial consequences of Transco's residual balancing actions are passed through to shippers in the form of energy balancing neutrality charges. Primary responsibility for gas balancing rests with shippers and Network Code incentives placed on both Transco and shippers are premised on reducing the magnitude and cost of Transco's residual balancing activities.

Shippers have a number of mechanisms available to them to assist them in balancing their portfolio. Historically this has included demand side interruptible contracts. Transco has become aware that gas consumers have, in recent years, become increasingly resistant to interruptible gas supply contracts containing rights to interrupt beyond Transco's contractual right. The current transportation charging arrangements are likely to be contributing to this trend given that a payment for greater than 15 days interruption will only be made where interruption is called by Transco.

It has become clear to Transco from discussion at recent NT&T workstream meetings that the level of demand side interruptible volume available to shippers for supply demand gas balancing has reduced. Consequently, under certain supply demand circumstances, Transco considers that it could be called upon to act in a primary gas balancing role and contrary to obligations placed upon shippers. Transco only interruption contracts prevent the shipper from offering the interruption on to the OCM[4] since the shipper would be unable to meet the turn down obligation. Therefore shippers, through markets, are prevented from valuing the interruptible demand product, in a gas balancing context, effectively against other gas balancing tools/mechanisms. This may lead to less than optimal gas balancing actions with the associated costs not being set at an efficient market rate, or indeed not being targeted to the parties primarily responsible for balancing the system.

The System Marginal Price (SMP) should provide the signal to shippers to balance their portfolio. Transco called supply demand interruption may lead to a shipper avoiding exposure to SMP, and in addition, potentially receive greater than 15 day interruption transportation credits.

Removal of supply demand interruption as a qualifying reason for calculation of additional payments over 15 days of interruption would reduce the incentive presented by the current charging methodology for gas consumers to contract with shippers solely for Transco initiated interruption. Transco considers the change proposed within this consultation paper would deliver the following benefits:

- Prevent distortionary impacts within the interruptible gas supply market;
- Prevent Transco from acting in a primary gas balancing role;
- Prevent distortionary impacts on gas balancing market mechanisms and ensure balancing costs are contained within Balancing neutrality.

It should be noted that, to date, interruption for supply demand management purposes has not been a feature of the interruption called by Transco since the introduction of the PC74 arrangements. However, developments within the interruptible supply market and the tightening supply and demand position indicate that Transco's role as the residual system balancer could be affected were interruption to be needed for the forthcoming winter for supply demand management purposes.

[4] On-the-day Commodity Market.

SO NTS Exit Capacity Investment Incentive

The introduction in 2002 of the NTS SO incentive scheme brought about an incentive on Transco to minimise the level of interruption that we call in our role of System Operator. This incentive is contained within the NTS Exit Capacity Investment Incentive where Transco is exposed to a level of additional cost should supply point interruption exceed 15 days in a formula year. In essence, Transco is incentivised to call interruption in a prudent manner and, where efficient, in order to avoid these costs provide additional exit capacity to reduce the likelihood of interruption being called i.e. invest to alleviate capacity constraints.

To date the interruption called by Transco has only been called for capacity constraint purposes. This is entirely consistent with the nature of the NTS exit capacity incentive in that Transco can influence the level of any additional cost through either efficient system operation or investment strategy. However, the same cannot be said for interruption arising from the requirement to manage supply and demand. Transco pipeline investment will not ease any requirement for such interruption.

Transco is concerned at the level of exposure, through the NTS Exit Capacity Incentive, that we and the industry could face should the need for Transco initiated supply demand interruption arise, and particularly where the SO NTS Exit incentive provides no mechanism to mitigate such exposure. Transco's performance within the NTS SO incentives has a direct impact on shippers to the degree of risk reward ratio established for each incentive. Transco understands that the form of "deep" NTS SO incentives will shortly be the subject of a consultation by Ofgem.

We feel it is inappropriate that the current transportation charge methodology in respect of the transitional NTS exit capacity arrangements should encourage the movement of costs from gas balancing to an investment incentive which was not intended to handle such costs.

Network Sensitive Loads (NSL)

One of the main benefits of implementing PC74 was the ability to differentiate between the different classes of interruptible supply point in terms of the relationship between the service provided to Transco and the level of transportation charge levied. Most notably this was evident within interruptible supply points classified by Transco as NSL for reason of their location and impact upon the gas transportation system. Within a background of mild winters and relatively low levels of interruption, NSL's continue to be more susceptible to interruption than non NSL's because of their higher level of locational transportation capacity support they offer to Transco.

It is unlikely that this proposal will affect the level of payment made to NSL's given that payments made to date have arisen as a result of capacity constraints on the transportation system. Going forward, we would not expect this position to change since locational capacity constraint triggers are generally lower than the trigger at which national supply demand interruption would be called. This proposal continues to recognise the level of service provided to Transco by ensuring the transportation credit paid is reflective of the actual frequency of interruption.

5. Method of Operation and Implementation

Transco would monitor the level of supply point interruption within the formula year running from 1st April to 31st March. The supply point count of interruption would increment by one for each day of interruption where such interruption was for the purpose of managing a capacity constraint or for the purpose of testing a supply point's ability to interrupt.

A payment by Transco to the shipper would be triggered for each additional day of interruption over 15 days. The payment for each additional day would be calculated on the basis of 1/15th of the annual firm NTS exit capacity charge and firm LDZ capacity charge that the interruptible supply point would have paid had it been connected to Transco's system on a firm transportation basis.

An implementation date of 1st October 2004 is proposed.

For the purpose of determining the count of qualifying interruption within formula year 2004/05, we propose that the count of interruption between 1st April 2004 and 30th September 2004 should not be re-appraised against the terms of the methodology proposed for implementation from 1st October 2004.

Transco will raise a Network Code Modification Proposal to clarify which interruption will qualify for the purpose of determining whether a shipper is due any greater than 15 day interruption transportation credits. The Network Code Modification Proposal will be pursued in parallel to the charging methodology proposal with the aim of enabling implementation, if proposed following consultation, for 1st October 2004.

6. Conclusion

In light of the observed developments within the transportation business, we believe it is appropriate to revise the transportation charging methodology to ensure that interruption arising for supply demand management purposes does not qualify for an interruptible transportation credit. We believe this to be consistent with the following relevant GT Licence objectives:

- Reflect developments within our transportation business by ensuring interruptible transportation credits do not discourage shippers from discharging their primary balancing role obligations, and this in a climate of a tightening supply and demand position.

- Ensure that our charges reflect the costs we incur within our transportation business since any interruption costs arising from supply deficit balancing actions would properly be contained within Balancing Neutrality.

7. Questions for Consultation

We would be pleased to receive views on whether the following proposed changes to our Transportation Charging Methodology meet Transco's relevant GT Licence objectives:

- That only interruption resulting from the following events should increment the supply point interruption count for the purpose of determining the level of payment made by Transco to a shipper for each additional day of interruption over 15 days:

  - Interruption for the purpose of managing a capacity constraint;
  - Interruption for the purpose of testing a supply point's ability to interrupt.

- That the methodology change be implemented with effect from 1st October 2004, and that the count of interruption between 1st April 2004 and 30th September 2004 should not be re-appraised to take account of the revised methodology.

The closing date for submission of your response is **Monday 14th June 2004**.

Your response should be e-mailed to stephen.emmerson@ngtuk.com or alternatively by post to Stephen Emmerson, Commercial Frameworks, National Grid Transco, NGT House, Gallows Hill, Warwick, CV34 6DA. If you wish to discuss any matter relating to this charge methodology consultation then please call on 01926 656214.

It would be helpful if your response could be copied to Ofgem by e-mail to andrew.walker@ofgem.gov.uk or by post to Andrew Walker, Ofgem, 9 Millbank, London, SW1P 3GE.

Responses to this paper will be incorporated within NGT's conclusion report. Should you wish your response to be treated as confidential, then please mark it clearly to that effect.