

CODE MODIFICATION PROPOSAL No. 0052
"Storage Withdrawal Curtailment Trade Arrangements in an Emergency"
Version 0.3

Date: 07/10/2005

Proposed Implementation Date: 21/11/2005

Urgency: Urgent

Proposer's preferred route through modification procedures and if applicable, justification for Urgency

(see the criteria at http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/2752_Urgency_Criteria.pdf)

E.ON UK request that this Modification Proposal be granted urgent status by the Authority as we believe that this proposal should be implemented prior to Winter 2005/06 peak demand periods. Without implementation of this proposal we believe that the shippers would be perversely incentivised to withdraw gas from storage earlier than might otherwise have been that case in the lead up to a possible Network Gas Supply Emergency (NGSE). This may precipitate a NGSE by causing a breach of (or indeed an anticipated breach of) Safety Monitors.

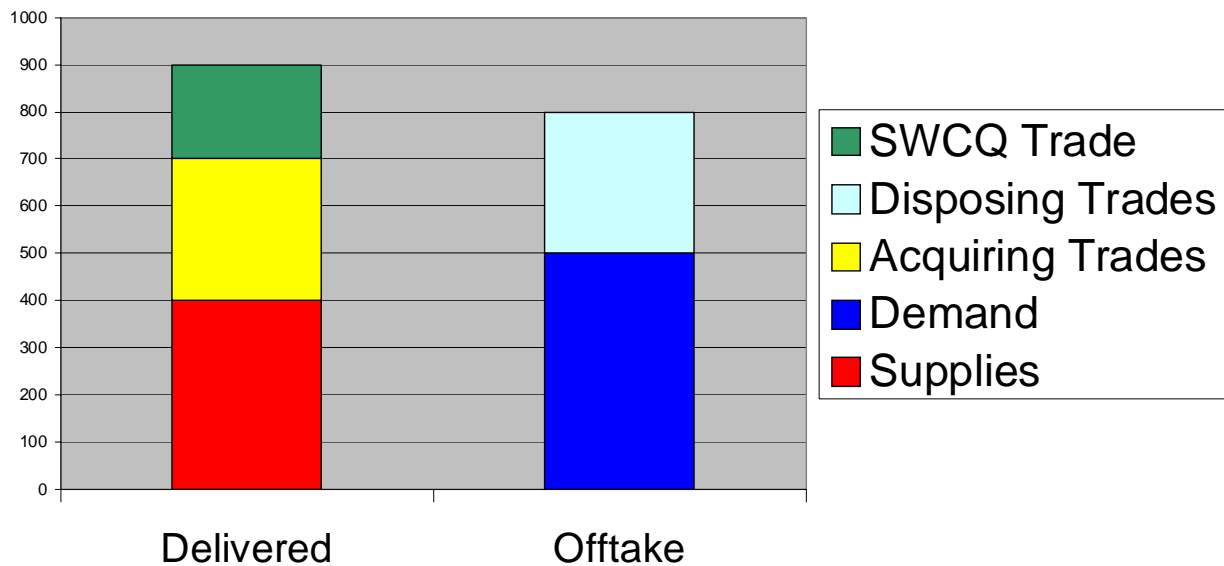
We would ask the Authority to agree to the proposed timetable outlined below which would include some opportunity to refine aspects of the proposal, e.g. in relation to calculation of the Storage Withdrawal Curtailment Quantity (SWCQ) and any possible requirement to establish a Storage Withdrawal Curtailment Quantity Methodology and/or a quantity dispute process.

Nature and Purpose of Proposal (including consequence of non implementation)

The aim of Modification 0044 was to encourage shippers to facilitate an early demand side response should there be a general shortage of gas on the system thereby helping Transco NTS in its role as Network Emergency Coordinator (NEC) avoid the need to declare a NGSE. With the implementation of Modification 0044 shippers face extremely strong incentives to avoid going short in an emergency as any such short position would be cashed out at SMP Buy price. Furthermore during an emergency daily metered demand curtailed by transporters prior to shipper curtailment (the Emergency Curtailment Quantity (ECQ)) would be deemed to have been sold by the relevant shipper to Transco NTS at the 30 day System Average Price, so that shippers do not 'benefit' from such actions taken by the relevant transporter under Emergency Procedures. At the same time and without any financial compensation from Transco NTS (via the cash-out mechanism or otherwise), shippers would almost certainly be prevented by the NEC from withdrawing gas from store¹. This is despite the fact that shippers would typically have planned to use storage withdrawals to help balance their position when supplies are tight. In effect shippers would arbitrarily be prevented from using storage flexibility when they most need it. No such 'physical' restrictions are placed on shippers' use of other forms of flexibility such as increasing beach deliveries ('swing') or reducing demand through commercial interruptions during an emergency. Indeed the changes introduced with Modification 0044 actively encourage shippers to make use of these substitute forms of upward flexibility.

Under the new arrangements, even the most prudent of shippers could face SMP Buy cash-out exposure because of the inability to access storage flexibility. Thus it is important that the quantity of flexibility shippers find themselves unable to use (the SWCQ) is instead acquired from the NBP and charged at a broadly 'neutral' market price i.e. the 30 day System Average Price. Conceptually this is the 'mirror image' of how the Emergency Curtailment Quantity (ECQ) is dealt with under the UNC.

User Daily Imbalance - Post Storage Withdrawal Curtailment + SWCQ Trade



The above chart shows the position of a prudent shipper who at the time of an emergency declaration was slightly long with storage nominated to cover some demand. Under the current UNC (post Modification 0044) this shipper would have a User Daily Imbalance of -100 given that it would have been prevented from delivering the green block. Under this proposal, the SWCQ would be considered to have been sold by Transco NTS to the shipper at 30 Day System Average Price. The result would be that the shipper would then be considered to have a positive User Daily Imbalance of 100. This long position would be cashed out at the prevailing System Average Price at the time the emergency was declared.

It is important to note that like other acquiring and disposing transactions under the UNC such as NBP title trades and ECQ Trades the adjustments to a shipper's balance position are financial in nature. Broadly speaking the SWCQ Trade adjustment is designed leave shippers positions financially neutral to the consequences of an NEC Storage Withdrawal Curtailment. As such the proposal is designed to ensure that 'appropriate' shipper behaviours are encouraged.

The proposal

The SWCQ on day one of an emergency would be equivalent to the shipper's aggregate prevailing Input Nominations at Storage Connection Points at the time a NGSE was declared less any storage quantities that may have actually been delivered. For subsequent days of an

emergency the SWCQ for each day shall be a quantity that could have reasonably be nominated for delivery at relevant Storage Connection Points (as permitted under contract with the relevant storage providers) if it had not been for NEC invoking Storage Withdrawal Curtailment.

On each day the SWCQ Trade would be purchased by the shipper from Transco NTS at the 30 day System Average Price (in concept this is effectively the reverse of the ECQ Trade which is sold by the shipper to Transco NTS). It is fair to say that other than in very exceptional circumstances (i.e. storage facility failure/operational difficulties or a localised Transco transportation constraint that limits deliveries) shippers expect storage input nominations to match actual deliveries.

If a trade were associated with the SWCQ, a User that did not have a negative Daily Imbalance prior to an emergency (by virtue of its expectation that its storage Input Nominations would be delivered) would not be financially exposed at the System Marginal Buy Price as a result of NEC stopping storage withdrawals. A User that was in balance or had in prospect, a positive Daily Imbalance prior to an emergency would retain a similar envisaged Daily Imbalance position following the invoking of Storage Withdrawal Curtailment. Storage Withdrawal Curtailment applies only at Storage Connection Points.

Trade and Trade Payment Arrangements

To ensure transparency and consistency with other Eligible Balancing Actions, Storage Withdrawal Curtailment during an NGSE would represent a Market Balancing Action, only for invoicing and neutrality purposes, and thus any payments received for such actions should be considered as part of the energy element of Balancing Neutrality.

For the avoidance of doubt, any amounts paid to Transco NTS by Users for the Storage Withdrawal Curtailment Quantity Trade would not be included in the calculation of the System Marginal Buy Price, the System Marginal Sell Price or the System Average Price. Transco NTS would not pay Balancing Charges, Balancing Neutrality Charges, Scheduling Charges or Daily Imbalance Charges as a result of the Storage Withdrawal Curtailment Quantity transactions occurring. This is consistent with current practice whereby Transco NTS as residual system balance does not pay such charges. Of course given Transco NTS in their capacity as NEC take on a more 'command and control' role rather than a residual role in an emergency there may be merit in directing some of these costs towards Transco NTS (but that is not the subject of this proposal).

In addition to the Trade Nominations in respect of the SWCQ, it is also proposed that for those occurrences i.e. curtailment during a NGSE Users would make a payment based on the SWCQ multiplied by a price determined as the simple average of the System Average Prices for the 30 Days prior to the commencement of the NGSE.

This would result in a payment from each User to Transco in respect of the aggregate quantity of gas that User would have delivered but for the Storage Withdrawal Curtailment occurring during an emergency. The Storage Withdrawal Curtailment Quantity would reduce aggregate imbalance in the Transco NTS 'Emergency Curtailment Manager' account. The net Daily Imbalance of all Users taking into account both Storage Withdrawal Curtailment Quantities and Emergency Curtailment Quantities should be equal and opposite to the aggregate imbalance of a new Transco NTS 'Emergency Curtailment Manager' account.

Calculation of the Storage Withdrawal Curtailment Quantity

Given that under normal circumstances shipper storage Input Nominations would be expected to match actual deliveries at the relevant Storage Connection Points we do not necessarily see the need to establish a complex methodology and subsequent claims process for the determination of daily SWCQ. In the interests of transparency and openness it should be possible to define most, if not all the processes and procedures necessary to derive the SWCQ within the UNC. Key elements that may be required include (a) a verification process for checking shippers entitlement to make storage Input Nominations at relevant Storage Connection Points (this may need to take account of the theoretical 'de-stocking' of gas that would have otherwise occurred if the NEC had not invoked Storage Withdrawal Curtailment, e.g. the cumulative SWCQs over the duration of a NGSE could be limited to the aggregate stock of gas held in store at the time a NGSE was declared) and (b) the impact of actual or partial storage outages. In its simplest form however, shippers storage Input Nominations both at the time a NGSE was declared and during the emergency could be taken at face value given the shipper licence obligation set out under Standard Condition 3(4);

"The licensee shall not knowingly or recklessly act in a manner likely to give a false impression to a relevant transporter as to the amount of gas to be delivered by the licensee on a particular day to that transporter's pipe-line system or as to the amount of gas to be comprised in its offtakes therefrom on that day."

It seems pretty clear that this applies to storage input nominations prior to and at the time the NEC invokes Storage Withdrawal Curtailment but during an emergency the interpretation may be less clear.

If it was felt necessary to define more detailed calculations within a 'SWCQ Methodology' this methodology would be ancillary to the Code and subject to proper oversight by the UNC Committee consistent with good governance principles outlined in Ofgem's approval of Network Code Modification 730 "Extending established Network Code governance arrangements to relevant Transco documents". This means that although Transco could propose changes to any SWCQ Methodology from time to time it would be necessary for the UNC Committee to approve any changes to such a document.

Consequences of not implementing this Modification Proposal

The consequence of not implementing this proposal is that prudent shippers that are rightly seeking to maintain stocks of gas in store to help sustain gas supplies for their customers throughout the whole winter period, would be (perversely) incentivised to withdraw that gas too early for fear of their gas being 'locked in store' in a NGSE. Such behaviour could cause or bring forward, the declaration of an NGSE, should Storage Monitors be breached or are about to be breached.

These perverse commercial incentives have been exacerbated by the move away from a 'neutral' emergency cash-out price to a much harsher marginal pricing regime with the implementation of Modification 0044. To illustrate this point it is worthwhile considering the possible 30 day System Average Price and SMP Buy price in a NGSE.. The values of 30 day System Average Price and SMP Buy price might conservatively be 50p/therm and £5/therm respectively in an NGSE. Under the pre Modification 0044 regime a shipper would pay 50p/therm cash-out for being short as a result of its gas being 'locked in store' by under Emergency Procedures whereas under the new regime it is now expected to pay £5/therm. This is hardly reasonable given one key reason it has invested in storage is to seek to cover this price risk under peak demand conditions.

In effect the current UNC discriminates against storage as a particular form of peak gas flexibility. This reduces the value and utility of storage for shippers who are more likely to turn to other forms of, perhaps less reliable, flexibility such as offshore swing and interconnector deliveries to satisfy their customer requirements in an emergency.

Failure to address the above concerns could threaten the ongoing security of the system and ultimately continuity of supply to customers.

Note 1: NEC rights to prevent shippers withdrawing gas from storage in an emergency are currently set out in the NEC Safety Case. This Safety Case has been agreed between the Health and Safety Executive and Transco NTS without consultation with shippers.

Proposed Implementation Timetable

Sent to Ofgem requesting Urgency	07/10/2005
Ofgem grant Urgent status	07/10/2005
Transmission Workstream/Workgroup session to consider/amend proposal	13/10/2005
Transmission Workstream/Workgroup session to consider/amend proposal	19/10/2005
Transmission Workstream/Workgroup session to consider/amend proposal (if necessary)	21/10/2005
Urgent Modification Proposal Issued for consultation	25/10/2005
Closeout for representations (8 business day consultation)	04/11/2005
FMR issues by Joint Office (+4 business days)	10/11/2005
Close-out for Panel Comments on responses	12/11/2005
Modification Panel Recommendation	17/11/2005
Ofgem decision expected	21/11/2005

Basis upon which the Proposer considers that it will better facilitate the achievement of the Relevant Objectives, specified in Standard Special Condition A11.1 & 2 of the Gas Transporters Licence

The coordinated, efficient and economical operation of the combined pipeline system requires fair and proportionate and non discriminatory incentives to be placed on shippers to seek to balance their positions under normal operations, in the lead up to a possible NGSE and during an actual NGSE. The current arrangements do not achieve this because shippers are perversely

incentivised to use storage flexibility early when the system is becoming tight (i.e. a forecast sustained cold weather snap) or when an NGSE is anticipated. Furthermore shippers will be encouraged to use other forms of perhaps less economic flexibility in preference to storage because they are not compensated for helping the system when the Emergency Procedures require shippers to keep gas in store. Ultimately this may help damage the prospect for further investment in storage capacity which the UK so desperately needs to support long-term security of supply.

Although we recognise that storage capacity may need to be conserved in an emergency Transco NTS in its development of the NEC Safety Case seem to have forgotten that they exist in a commercial world and that their free option to 'lock gas in store' without compensation has profound commercial consequences on shippers. Shippers will naturally respond to these commercial imperatives. Nevertheless shippers are acutely aware of their wider obligations to customers, which may lead them moderate their response which may in fact put a brake on how fast gas stocks are reduced.

It would be wrong for prudent shippers who have chosen to rely heavily on storage capacity to meet peak supplies to customers to be unduly discriminated against, just because less prudent shippers have decided to withdraw gas from storage at must faster rates. By addressing the perverse incentive that penalises shippers from maintaining adequate stocks of gas in store, prudent shippers are less disadvantaged than before. Thus this proposal will promote greater and more effective competition in the shipping and supply of gas.

Any further information (Optional), likely impact on systems, processes or procedures, Proposer's view on implementation timescales and suggested text

Given that the Storage Withdrawal Curtailment Quantity purchased by a shipper from the system via a disposing trade is effectively the 'mirror image' of the acquiring trade for a shipper purchasing energy from the system for the Emergency Curtailment Quantity we consider it should be relatively straight forward to rework Modification 0044 drafting for this proposal.

Code Concerned, sections and paragraphs

Transportation Principal Document

Offtake Arrangements Document

Transportation Principal Document:

Section F - System Clearing, Balancing Charges and Neutrality

Section Q - Emergencies

Offtake Arrangements Document:

Section C - Safety and Emergency

Proposer's Representative

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Proposer

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Signature

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