

Modification proposal:	Uniform Network Code (UNC) 0196: Alterations to shippers penalties for end user failure to interrupt (UNC196)		
Decision:	The Authority ¹ has decided to reject this proposal		
Target audience:	The Joint Office, Parties to the UNC and other interested parties		
Date of publication:	20 June 2008	Implementation Date:	N/A

Background to the modification proposal

The Uniform Network Code (UNC) Transition Document Part IIC Transitional Rules, paragraph 9.9.6 to 9.9.9 of the Transitional Interruption Regime: Interruptible Supply Points section, states that if on a User's Portfolio the number of failures to interrupt exceeds five in any one gas year, then all the Interruptible Supply Points of which the User is the Registered User will be redesignated as Firm, save where the Firm Transportation Requirement would not be satisfied and in such cases only the revised Firm Transportation Charges would be applied. The Firm Transportation Requirement is the level of capacity that, taking into account the transporter's ability to interrupt at other supply points, would be required to support the capacity needs of supply points redesignated Firm. The Firm Transportation Requirement is currently defined in UNC Transition Document Part IIC Transitional Rules paragraph 9.3.4.

The proposer considers that the consequences of enforcing this section of the UNC generally carry a disproportionate and unduly onerous risk for shippers and, in particular, that paragraph 9.9.9 does not provide enough clarity as regards the definition of the 'reasonable steps' that shippers would be expected to undertake to avoid facing such consequences.

The proposal was raised on 21 February 2008 and at that time the paragraphs relating to shipper penalties for failure to interrupt were located in the UNC Transportation Principal Document (TPD) Section G 6.9.6 to 6.9.9. On 1 April 2008 Section G 6.9.6 was modified and retained. At the same time, Section G 6.9.6 to 6.9.9 inclusive as they applied on 31 March 2008 were relocated to the UNC Transition Document Part IIC Transitional Rules following the Authority's direction in UNC 90 'Revised DN interruption arrangements' that from 1 October 2011, reformed interruption arrangements will take effect. Implementing UNC 90 means that from 1 October 2011 the current UNC provision of shipper penalties for failure to interrupt will cease to have effect. Under the reformed interruption arrangements all customers will pay Firm Transportation Charges regardless of their interruptible status. Thus, from 1 October 2011, the shipper penalty of having an entire portfolio of interruptible customers redesignated firm will be rendered meaningless, since shippers will be paying Firm Transportation Charges for each supply point at which they are the registered User in any case.

The modification proposal

This proposal seeks to address the perceived shortcomings of the existing penalties on shippers for failure to interrupt by removing TPD Section G 6.9.6 to 6.9.9 from the UNC, and paragraph 9.9.6 to 9.9.9 of the UNC Transition Document Part IIC, where the 'failure to interrupt' section of the UNC has been located since 1 April 2008. The proposal does not consider that an alternative to the existing provision is necessary, and no replacement legal text has been proposed.

¹ The terms 'the Authority', 'Ofgem' and 'we' are used interchangeably in this document. Ofgem is the office of the Gas and Electricity Markets Authority.

The proposer considers that the consequences of enforcing this section of the UNC would have a disproportionately penal affect on the competitive position of an affected shipper relative to the market. In addition, the proposer considers that since in an emergency, transporters reserve the right to physically isolate customers who have failed to interrupt², there is no need to place a formal incentive on shippers to facilitate the process. Paragraph 9.9.9 of the Transition Rules provides that the penalty set out in 9.9.8 will not apply where a shipper is able to demonstrate that they have taken reasonable steps to comply with the requirement to interrupt and that the failure to interrupt occurred despite such steps being taken. The proposer considers that this paragraph should be removed on the grounds that there is not enough clarity as regards what gas transporters consider 'reasonable steps' to be.

The proposer considers that the proposal, in removing the potential penalty on shippers from customers' failure to interrupt, will facilitate the achievement of the transporters' relevant objective - the securing of effective competition - set out in Standard Special Condition A11(1)(d) of the gas transporter licence. The proposer does not consider that the proposal will impact on any of the other relevant objectives.

UNC Panel³ recommendation

The UNC panel voted on this proposal on 15 May 2008. Of the eight voting members on the panel, capable of casting ten votes, two votes were cast in favour of implementing the proposal; therefore the panel did not recommend implementation.

The Authority's decision

The Authority has considered the issues raised by the modification proposal and the Final Modification Report (FMR) dated 15 May 2008. The Authority has considered and taken into account the responses to the Joint Office of Gas Transporters consultation on the modification proposal, which are attached to the FMR⁴.

The Authority has concluded that implementation of the modification proposal will not facilitate the achievement of the relevant objectives⁵ of the UNC.

Reasons for the Authority's decision

In reaching this decision we have considered the extent to which the proposal facilitates the achievement of the relevant objectives as set out in Standard Special Condition A11(1):

² Section G 6.10.2 of the UNC states that where there is a failure to Interrupt at a Supply Point and the DN Operator determines that the failure to Interrupt results in a significant risk to the security of the relevant System the DN Operator may take any steps available to it to isolate or disconnect any or all Supply Meter Points. Paragraph 3.6.1 of Section G states that nothing in the Code shall prevent the Transporter from ceasing the flow of gas at any Supply Meter Point where it appears to the Transporter that it is necessary to do so for the purposes of ensuring safety. In addition, Transporters have powers under the Gas Safety (Management) Regulations 6(4) and 6(5) of the Gas Act to direct customers not to consume gas to prevent a supply emergency.

³ The UNC Panel is established and constituted from time to time pursuant to and in accordance with the UNC Modification Rules.

⁴ UNC modification proposals, modification reports and representations can be viewed on the Joint Office of Gas Transporters website at www.gasgovernance.com

⁵ As set out in Standard Special Condition A11(1) of the Gas Transporter Licence, see: http://epr.ofgem.gov.uk/document_fetch.php?documentid=6547

Standard Special Condition A11.1(a): the efficient and economic operation of the pipe-line system to which this licence relates;

The proposer did not consider that the proposal would impact on this objective, but two transporters considered that it had the potential to adversely affect the achievement of the objective. Both transporters were of the view that to the extent that the proposal resulted in a greater probability of transporters having to undertake physical isolations of customers, it had the potential to hinder the economic and efficient operation of the system. It is understood that where a customer fails to interrupt, and physical isolation is necessary, transporters incur a cost in having to discharge this duty.

In considering this issue, we note that the principal provision within the UNC for ensuring that interruptible customers interrupt when required is contained in paragraph 9.9.1 to 9.9.5 of Transition Document Part IIC Transitional Rules. Sub-paragraph 9.9.2 specifies that on the first day that an interruptible supply point fails to interrupt the registered User will pay charges equivalent to two times the annual capacity charge payable if the supply point had been registered as Firm. For each and every subsequent day of failure to interrupt Users are subject to a penalty charge roughly equivalent to two times the market value of the gas consumed at the supply point on the day of the failure. The UNC defines a contractual relationship between shippers and transporters, but it is recognised that shippers have the contractual freedom to pass penalties for individual supply point failure to interrupt on to the customers who have triggered the penalties. Instances of failure to interrupt are relatively rare and on this basis it could be said that the direct penalties on interruptible customers provide an effective incentive to comply with the requirement.

Nonetheless, the relationship between an interruptible customer and their shipper is integral to the effective functioning of the network interruption arrangements. Under the existing interruption arrangements, large customers nominate themselves as interruptible through their shipper. Since transporters have no direct contractual relationship with customers, they are therefore dependent on shippers to ensure that interruptible customers are fully aware of the consequences of failing to interrupt.

The penalty on shippers for an individual supply point's failure to interrupt, set out in 9.9.2, currently applies in conjunction with the penalty on shippers set out in 9.9.6 to 9.9.9, therefore the precise effect of each in ensuring a reliable interruption response cannot be measured with certainty. To date, failure to interrupt penalties for greater than five supply point failures to interrupt have never been triggered or levied on shippers. On this basis, regardless of whether the penalties are considered proportionate, the arrangements in conjunction appear to deliver what they are designed to do. We consider that shippers do have an important role in contributing to an effective interruption response at times of network constraint. In our view the proposal's intention to remove a direct incentive on shippers to fulfil this obligation, could have the marginal effect of increasing the probability that transporter executed physical isolations could be necessary. On this basis we would agree that the proposal carries a small risk of adversely affecting the efficient and economic operation of the pipe-line system.

Standard Special Condition A11.1(b): so far is consistent with sub-paragraph (a), the coordinated, efficient and economic operation of

- (i) the combined pipe-line system, and or***
- (ii) the pipe-line system of one or more other relevant gas transporters;***

No representation was made regarding this objective, and the Authority is satisfied that the proposal would not impact upon it.

Standard Special Condition A11.1(c): so far is consistent with sub-paragraph (a) and (b), the efficient discharge of the licensee's obligations under this licence;

No representation was made regarding this objective, and the Authority is satisfied that the proposal would not impact upon it.

Standard Special Condition A11.1(d): so far is consistent with sub-paragraph (a) to (c), the securing of effective competition:

- (i) between relevant shippers;***
- (ii) between relevant suppliers;***
- (iii) between DN operators (who have entered into transportation arrangements with other relevant gas transporters) and relevant shippers;***

The proposer considers that the proposal would better facilitate effective competition between shippers, on the basis that if the failure to interrupt penalty on shippers was removed, shippers would no longer run the risk of having their portfolio of interruptible customers charged as firm. In the event that the failure to interrupt penalty was applied, the proposer considers that this would have a potentially significant financial impact with implications for their standing relative to other shippers in the market. This view was not supported by any of the transporters who responded. Five shippers who responded supported the proposal, but only two suggested that the proposal would facilitate effective competition. Both of these respondents considered that the existing shipper penalty could be viewed as a barrier to entry in the interruptible market and that the proposal would facilitate competition by removing this barrier.

As noted above, the failure to interrupt penalties on shippers as set out in Transition Document Part IIC Transitional Rules paragraph 9.9.6 to 9.9.9, have never been administered; therefore in our view, the effect of applying the penalty on the level of competition between shippers cannot be stated with certainty. At the moment there is no evidence to suggest that the existing arrangements have had a detrimental effect on securing effective competition between shippers, and we have not seen any evidence to suggest that they have been a barrier to entry in the market. On this basis we do not agree with the proposer that the proposal will facilitate the achievement of the relevant objective set out in Standard Special Condition A11.1(d). The shipper penalties for failure to interrupt are applied on a non-discriminatory basis, and we do not consider that their application has had a detrimental effect on the level of competition between shippers.

We would further note, that in the event that greater than five customers within a single shipper's portfolio failed to interrupt within a single year, it would seem reasonable to consider the role the shipper had played in attempting to mitigate this outcome. Paragraph 9.9.9 permits shippers to avoid the penalty if they can demonstrate that they took reasonable steps to comply with the requirement to interrupt. The proposer considers that the meaning of this paragraph lacks clarity. In our view, concerns about the meaning of the paragraph are an insufficient justification for its removal and we do not consider that there is any evidence to suggest that its removal will facilitate the achievement of the transporters relevant objective of securing effective competition.

Standard Special Condition A11.1 (e): so far as is consistent with subparagraphs (a) to (d), the provision of reasonable economic incentives for relevant suppliers to secure that the domestic customer supply security standards... are satisfied as respects the availability of gas to their domestic customers;

Two respondents consider that the proposal has the potential to have a detrimental effect on security of supply. In our view this potential is strongly mitigated against by the transporters' ultimate right to isolate certain customers on their networks. We have indicated that, to a limited extent, the proposal could be viewed as increasing the relative probability that transporter invoked isolations may be necessary, but given that as system operator, the transporter has a clear and unambiguous responsibility to ensure security of supply, we would not expect the proposal to have a credible impact on a transporter's ability to deliver this. In the event that the proposal was directed for implementation we would expect that transporters would take steps to ensure that security of supply was unaffected, albeit that it could be argued that this might come at a marginally increased cost, which could have an adverse affect on the efficient operation of the pipe-line network.

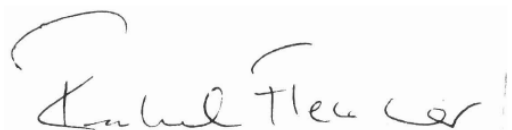
We do note however, that the proposer's view that responsibility for security of supply is adequately provided for by the transporters right to undertake physical isolation of supply points which fail to interrupt, could be viewed as an inaccurate interpretation of how the power was intended to be applied. We would point out in particular, that the emergency provisions detailed in the Gas Safety (Management) Regulations are intended for use as a measure of last resort and are not expected to be deployed lightly.

Standard Special Condition A11.1 (f): so far as is consistent with subparagraphs (a) to (e), the promotion of efficiency in the implementation and administration of the network code and/or the uniform network code;

No representation was made regarding this objective, and the Authority is satisfied that the proposal would not impact upon it.

Concluding Statement

The Authority's decision, taking into account the issues addressed above, is that the proposal should be rejected. It is hereby rejected. The Authority does not consider that the proposal will facilitate the achievement of any of the relevant objectives set out in Standard Special Condition A11.1.



**Rachel Fletcher
Director of Distribution**

Signed on behalf of the Authority and authorised for that purpose.