

Modification proposal:	Uniform Network Code (UNC): Enduring arrangements for supply point capacity decrease at an interruptible supply point (UNC215)		
Decision:	The Authority ¹ directs that this proposal be made ²		
Target audience:	The Joint Office, Parties to the UNC and other interested parties		
Date of publication:	21 October 2008	Implementation Date:	To be confirmed by the Joint Office

Background to the modification proposal

Interruptible capacity is used by the Gas Distribution Networks (GDNs) as a system management tool which, alongside linepack, network investment and incremental NTS offtake capacity, helps them manage their licence obligations to economically and efficiently meet the gas transportation needs of customers connected to their pipeline network.

On 15 March 2007, the Authority directed implementation of UNC 090 introducing reformed interruption arrangements on distribution networks. From 1 October 2011 all LDZ supply points will be considered firm, and any supply point wanting to have an interruptible supply will have to enter a tendering process with the relevant Gas Distribution Network (GDN). Under the new arrangements, tenders to secure an Interruptible tranche, or tranches³ will be held at least annually for interruption requirements for up to three years ahead of the applicable Gas Year. The first set of competitive tenders were held in June 2008 inviting supply points to secure interruption rights for up to five years⁴ in length from October 2011.

On securing the interruption capacity, the supply point will be subject to arrangements set out in UNC TPD Section G 6.1.6 if the user wants to increase or decrease the Supply Point Capacity (SOQ). Under UNC TPD Section G 6.1.6 (a) any increase in SOQ over the prevailing SOQ will be treated as firm, and there will be no effect on the Interruptible tranche of SOQ in any interruption period.

The arrangements for a decrease in the SOQ at an Interruptible supply point are set out in UNC TPD 6.1.6 (b). Any reduction in SOQ is first applied to reduce the interruptible capacity, which can fall to zero if the reduction in SOQ exceeds the interruptible capacity. If there is any remaining amount, the decrease in SOQ is then applied to reduce the amount of the Firm capacity. If the remaining interruptible capacity is less than the Minimum Interruptible Amount, it will be designated as Firm Supply Point Capacity. Currently, there is no mechanism in the UNC for either the GDN or user to impact on the process in deciding whether they would prefer to reduce first the firm rather than the Interruptible capacity.

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.

² This document is notice of the reasons for this decision as required by section 38A of the Gas Act 1986.

³ Value of a tranche, or sum of tranches (no more than nine) can be up to the value of the SOQ

⁴ 2008 annual tender held for Gas Years 2011/12 to 2015/16.

The modification proposal

The proposal was raised by Wales and West Utilities (WWU) on 8 May 2008 with the intention of allowing the user and GDN to make alternative arrangements to the one described under UNC TPD 6.1.6 (b) when there is a decrease in the SOQ at an interruptible supply point.

The proposed arrangements would, following agreement between the user and the GDN allow for any decrease in the SOQ to reduce the Firm supply point capacity, while leaving the tendered for interruptible capacity unchanged. However, if either of the two parties did not want to retain any of the proposed decrease in SOQ as interruptible, then the existing arrangements under UNC TPD G 6.1.6 (b) would apply.

For the majority of cases, a reduction in SOQ will see a reduction in overall demand in the location zone, thereby reducing the amount of interruption capacity required by an equal amount. In these cases the current arrangements under UNC TPD G 6.1.6 (b) would provide for an appropriate reduction in interruptible capacity in the location zone. The proposer noted however, that there may be instances when this will not be the case due to other network demand increases/constraints, other interruptible supply points wanting to redesignate as firm and a GDN not being able to fulfil its interruption requirements for the location zone that the supply point reducing its SOQ resides in.

The proposal would only impact on those supply points that secure interruptible rights from October 2011. Supply points that are currently interruptible will be subject to the existing arrangements under UNC TPD 6.1.6 (b).

The proposer considers that this modification is of importance given the change in the structure of transportation charges from 1 October 2008. On 13 December 2007 Ofgem published its decision not to veto the joint GDN proposal⁵ to amend their charging methodologies set out in DNPC03⁶. One result of the amendment increases the proportion of revenue collected from Use of System capacity charges from 50% to 95%, while decreasing the proportion collected from commodity charges from 50% to 5%.

Since interruptible supply points were not subject to capacity charges prior to October 2008 there had been no incentive for shippers to nominate correctly their booked capacity. This has resulted in a divergence between booked and actual capacity requirements. However, as interruptible supply points will have to pay capacity charges from 1 October 2008, shippers will be incentivised to ensure that booked capacity matches actual requirements.

Therefore, such interruptible supply points may look to revise SOQ values during the Capacity Reduction Period that occurs between October and January. While any reduction in SOQ posted by existing interruptible supply points will continue to impact the interruptible element as set out under UNC TPD 6.1.6 (b), under this proposal supply points securing interruption for October 2011 and beyond will be able to reduce firm capacity and retain its interruptible capacity on agreement between the GDN and supply point.

⁵<http://www.ofgem.gov.uk/Networks/GasDistr/GasDistrPol/Documents1/Decision%20Letter%20on%20DNPC03%2013Dec07.pdf>

⁶ 'LDZ system charges – capacity/commodity split and interruptible discounts'

Without this modification, a downward revision in the SOQ for a supply point that has booked interruptible capacity for 2011 and beyond, will see a reduction or total removal of that interruptible capacity under the existing arrangements in UNC TPD G 6.1.6 (b).

UNC Panel⁷ recommendation

At its meeting on 17 July 2008, the UNC Modification Panel voted by a panel majority of 10 votes to recommend the implementation of this proposal.

The Authority's decision

The Authority has considered the issues raised by the modification proposal and the Final Modification Report (FMR) dated 19 September 2008. The Authority has considered and taken into account the responses to the Joint Office's consultation on the modification proposal which are attached to the FMR⁸. The Authority has concluded that:

1. implementation of the modification proposal will better facilitate the achievement of the relevant objectives of the UNC⁹; and
2. directing that the modification be made is consistent with the Authority's principal objective and statutory duties¹⁰.

Reasons for the Authority's decision

The Joint Office received six responses to its consultation on UNC215 from three GTs and three shippers. They all supported the modification proposal, although one respondent provided only its qualified support due to the absence of a methodology.

This respondent considered that it would be beneficial if the GDNs could develop a methodology to identify circumstances when this option would be implemented. They questioned the likelihood that a decrease in SOQ by one user will always be accompanied by an increase in SOQ by another user. As such, it was considered that there could be potential for cross-subsidies to occur. The proposer of the mod responded by stating that while on a one to one basis, an SOQ reduction by one user is unlikely to be matched by a simultaneous increase in SOQ by another user in the same location zone, there would be other circumstances when the freeing up of that SOQ would be used. With regard to the issue of cross-subsidies, the proposer discounted that this would happen on the basis that GDNs would need to evaluate whether its more economic and efficient to make Interruption Option¹¹ payments or to carry out investment to take account of capacity constraints. As such the proposer did not see the need for a methodology.

⁷ The UNC Panel is established and constituted from time to time pursuant to and in accordance with the UNC Modification Rules

⁸ UNC modification proposals, modification reports and representations can be viewed on the Joint Office of Gas Transporters website at www.gasgovernance.com

⁹ As set out in Standard Special Condition A11(1) of the Gas Transporters Licence, see: http://epr.ofgem.gov.uk/document_fetch.php?documentid=6547

¹⁰ The Authority's statutory duties are wider than matters which the Panel must take into consideration and are detailed mainly in the Gas Act 1986.

¹¹ Payable from October 2011 by GDN to interruptible supply point regardless of whether interruption actually occurs.

Respondents voiced their support for the proposal and the flexibility it gave both interruptible users and GDNs on how a reduction in SOQ is managed. They also noted the benefits that other users in the same location zone would have, in being able to obtain firm capacity without incurring reinforcement. Overall they agreed that the proposal would allow for the efficient and economic operation of the pipeline system.

Two respondents noted that without this modification the GDN may be required to hold an ad-hoc interruptible tender should the user want to replace the interruption capacity lost following an SOQ reduction. The holding of such a tender was considered to be an inefficient and costly process.

We consider that the modification proposal will allow GDNs to take account of the anticipated drop in nominated SOQ at interruptible supply points following implementation of DNPC03 on 1 October 2008. Since interruptible supply points have been exempt from paying capacity charges prior to October 2008, there has been no incentive for shippers to nominate correctly their booked capacity. This has resulted in a divergence between booked and actual capacity requirements. From October 2011, supply points with interruptible capacity will no longer receive any discount to the capacity charge, and as such we expect shippers to post more accurate SOQ nominations during the Capacity Reduction Period.

While we anticipate SOQ volumes to fall in the zones where interruptible users are located, we may not necessarily want the tendered for interruption capacity to decline. Such a reduction could potentially negate the benefits of Interruption Reform under UNC 090, which included amongst other things, enabling the GDNs to make more efficient trade-offs between contracting for interruption, purchasing NTS offtake capacity and investing in their own networks, while also improving security of supply through greater certainty about the availability of Interruption.

We set out below the reasons why we have concluded that the proposal would better facilitate the relevant objectives:

Relevant Objective (a) – the efficient and economic operation of the pipe-line system to which this licence relates;

We concur with the proposer and those respondents who stated that the proposal would better facilitate the efficient and economic operation of the GDN's pipe line system. Reducing the firm SOQ would free up spare capacity that could be reallocated to another user, thereby avoiding the need for the GDN to invest to provide that capacity. It can also be used to alleviate an existing or future constraint, should for example, the amount of interruption tendered for in the area fall short of the GDN's requirements.

In addition, allowing the user to retain its interruptible capacity following a reduction in SOQ would satisfy the interruption requirements of both the user and the relevant GDN. We consider that a supply point which has secured an Interruptible contract for 2011 and beyond, will have done so on the basis that it is the most economic and efficient way for the GDN to manage their capacity requirements. That is, more economic and efficient than undertaking reinforcement work or carrying out a costly and lengthy process of holding an ad-hoc tender to secure replacement interruptible capacity.

Relevant Objective (b) – so far as 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

We agree that the modification will, by satisfying the Interruptible capacity requirement within a network, allow the GDN and the upstream transporter to operate the combined pipe-line system in an coordinated, efficient and economic way. Without this modification, the loss of interruptible capacity resulting from a reduction in SOQ may lead the GDN to increase NTS Exit capacity and Offtake pressures in order to alleviate potential capacity constraints. Both of these measures will impact on the upstream transporter.

Relevant Objective (c) – the efficient discharge of the licensee’s obligations under this licence;

We agree with the proposer that the proposal will better achieve this relevant objective as it will assist the GDN in planning and developing its pipe-line system in accordance with SSC A9¹². It will allow the GDN to manage better the amount of interruptible capacity available against the operation and development of the network.

Relevant Objective (d) – the securing of effective competition;

We support the view that implementing this proposal will allow users to maintain available and required interruptible capacity that has been secured through the annual or ad-hoc interruption invitation. As such implementing UNC 215 would help in securing effective competition between relevant users.

Relevant Objective (f) – so far as is consistent with sub-paragraphs (a) to (e), the promotion of efficiency in the implementation and administration of the network code and/or the uniform network code;

We agree that the proposal will better facilitate the promotion of efficiency in the administration of the network code as the mandatory arrangements and process that currently exists will not be invoked if the user and the GDN agree otherwise.

Decision notice

In accordance with Standard Special Condition A11 of the Gas Transporters Licence, the Authority hereby directs that modification proposal UNC 215: ‘Enduring arrangements for supply point capacity decrease at an interruptible supply point’ be made.



**Rachel Fletcher,
Director of Distribution**

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

¹² ‘Pipe-line system security standards’