

TRANSCO WORKSTREAM REPORT

"Demand Side Contestable Services"

Version 1.0

1. Background to The Modification Proposal

The background to this Modification Proposal was described in the Proposal as follows:

"This Modification Proposal replaces Modification Proposals 0584 and 0585 and is being raised as a result of discussions that have been held with HSE, Ofgem and Shippers over recent months."

Previous Workstream Reports for Modification Proposals 0584 and 0585 reflected the discussions that took place within the NT&T Workstream which preceded the replacement of these Proposals with Modification Proposal 0605.

2. Description of The Modification Proposal

Within the context of these discussions with HSE, Ofgem and Shippers, the Modification Proposal was described as follows:

"Pending the submission of a material revision to its Safety Case, these discussions have led Transco to conclude that use of demand-side services should be facilitated for a wide range of applications, notably to include Energy Balancing as well as OM and TS to potentially allow it to better respond to its incentives in the interests of all industry participants. In the short term this may allow more efficient use of the demand-side services, as Transco does not anticipate reducing its storage bookings until such time as the effectiveness of demand-side contracts has been proven. Consequently, for 2003/04, the services will be supplementary to bookings capable of meeting the whole of Transco's OM and TS requirements.

Implementation of this Network Code Modification Proposal would enable Transco to enter into demand-side contracts and recover efficiently incurred costs via the appropriate mechanism.

When Transco exercises an option to call on one of these services, implementation of the Modification Proposal would allow Transco to recover the relevant proportion of the associated costs provided the costs were efficiently incurred. During the period when it cannot reduce the level of its storage bookings, implementation of the Proposal would allow Transco to recover the full costs of the demand-side services from Users.

It is intended that the contracting process would be consistent with the Procurement Guidelines, operated in accordance with the System Management Principles, and that the following two forms of contract would be used:

- "Low-flow" – where the Service Provider would ensure that off-take did not exceed a specified rate, which would be below the equivalent supply point SOQ; and
- "Rate-change" – where the Service Provider would turn down the current flow by a set amount.

The form of implementation of these Service Contracts would be similar to those already adopted by Transco for entry capacity management."

3. Workstream Discussion

This Proposal was discussed at the meeting of the Planning and Security (including Storage) Sub-Group (PSS) on 7 January 2003.

Transco had previously tabled draft business rules for parallel-running together with term sheets for the two proposed forms of contract. Users had responded to these when tabled and in subsequent correspondence with Transco. On the basis of these responses, Transco had compiled an issues list which was discussed.

Ofgem had also circulated beforehand to all Shippers an explanatory note indicating that Transco's LNG services should continue to be defined within the Network Code for the 2003/4 Storage Year. This contrasted with the intention behind Modification Proposal 0548 which envisaged separation of LNG service provision prior to 2003/04 Storage Year. The meeting was of the view that retaining the existing contractual structure would reduce the urgency for development of contestable services. However, the consensus view was that it was worthwhile continuing development of parallel operation which could be enacted prior to any separation of the LNG business provided that such separation was anticipated ahead of the 2004/05 Storage Year. Other points discussed were as follows:

- The potential adoption of a new Exit Regime was insufficient reason for delaying progress on parallel operation - in fact useful information might be obtained to guide development of the Exit Regime.
- If the new Service Contracts were used in a restricted way for energy balancing purposes, the effect of OCM liquidity was expected to be very low.
- Different tick sizes for the two services were felt to be potentially discriminatory and Transco agreed to consider this further. It was pointed out that tick sizes had been suggested to make the regime manageable and applying the lower tick size nationally would potentially produce a large number of sites.
- There was some discussion on likely option vs exercise prices for demand side vs supply side (ie LNG). There was a risk that lowest cost principles would lead Transco to always exercise supply side measures (with high sunk costs and zero exercise price) and this would reduce the value of parallel operation.
- It was recognised that Transco discretion or a rule-based acceptance criteria would be required to contain costs, even with LNG providing indicative option price and exercise prices.
- There was a clear divergence of views on how parallel operation might be financed. Transco had requested a view from Ofgem and was awaiting a response.

As some of the above discussion points had not been resolved, the meeting concluded that this Proposal should not proceed to consultation at this stage.

4. Recommendation

The NT&T Workstream therefore recommends that **Modification Proposal 0605 remain with the Workstream.**