

****DRAFT** CODE MODIFICATION PROPOSAL No.**
"Storage Withdrawal Curtailment Trade Arrangements in an Emergency."

Date: 08/10/2005

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 requests 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 will be perversely incentivised to withdraw gas from storage earlier than might otherwise have been that case in the lead up to a possible gas emergency. This may precipitate an emergency 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 and any requirement to establish a Storage Withdrawal Curtailment Quantity Methodology and/or the establishment of a quantity dispute process.

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

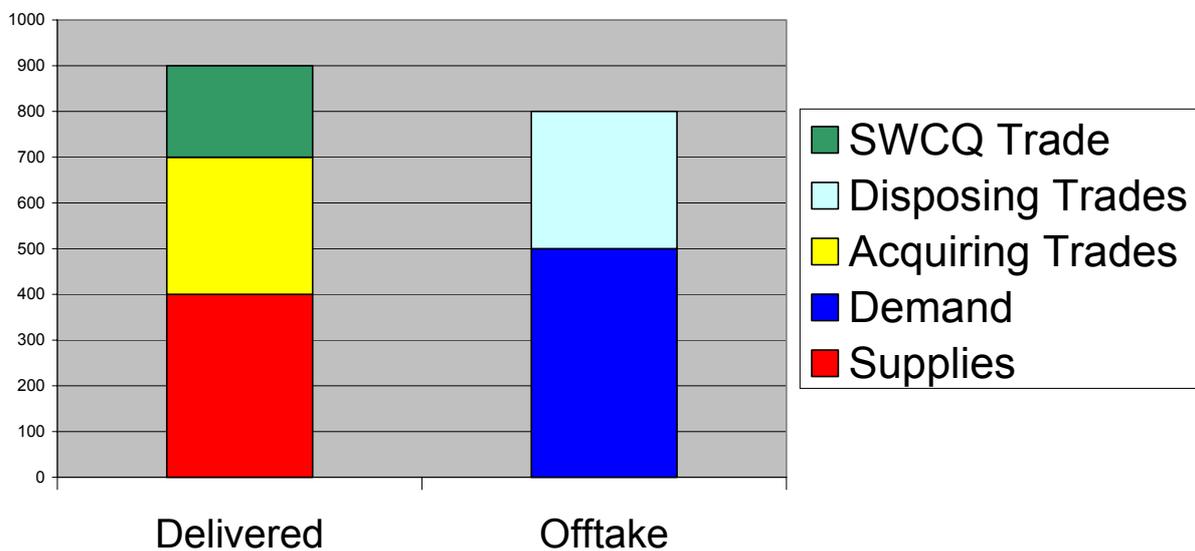
The aim of Modification 0044 was to encourage shippers to facilitate an early demand side response should there be a general shortage of gas on this system thereby helping Transco NTS avoid the need to declare an emergency. With its implementation shippers face extremely strong incentives to avoid going short in an emergency as any such short position would be cashed out at SMP Buy price. Furthermore during any 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 Transco intervention. At the same time and without any financial compensation from Transco NTS, shippers are prevented from withdrawing gas from store¹. This is despite the fact that shippers almost certainly would have planned to use storage withdrawals to help balance their position when supplies are tight. In effect shippers are arbitrarily 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

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

during an emergency. Indeed the Modification 0044 changes 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 his inability to access storage flexibility. Thus it is important that the quantity of flexibility shippers find themselves unable to use (the Storage Withdrawal Curtailment Quantity (SWCQ)) is instead acquired from Transco at a '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 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 he would have been prevented from delivering the green block. Under this proposal the SWCQ is considered to have been sold by Transco to the shipper at the 30 day System Average Price. The result being that the shipper would now 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.

The proposal

The SWCQ would be equivalent to the shipper's aggregate daily storage delivery nominations (i.e. the prevailing nomination allocation) at the time an emergency was declared less any storage quantities that may have actually been delivered. This quantity would become a SWCQ Trade in which a shipper would purchase 'energy' from Transco (effectively the reverse of the ECQ Trade where 'energy' is sold to Transco) at the 30 day System Average Price. It is fair to say that except in very exceptional circumstances (i.e. storage facility failure/operational difficulties

or a localised Transco transportation constraint that limits deliveries) shippers expect storage nominations to match actual deliveries.

If a trade were associated with the Storage Withdrawal Curtailment Quantity, a User that did not have a negative Daily Imbalance prior to an emergency (by virtue of its expectation that its storage nominations would be delivered) would not financially exposed at the System Marginal Buy Price as a result of Transco stopping storage withdrawals. A User that was in balance or had 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 emergency 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 shall not be included in the calculation of the System Marginal Buy Price, the System Marginal Sell Price or the System Average Price. Transco NTS will not pay Balancing Charges, Balancing Neutrality Charges, Scheduling Charges or Daily Imbalance Charges as a result of the Storage Withdrawal Curtailment Quantity transactions occurring.

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

This would result in a payment from to 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 new 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 shipper delivery nominations would be expected to match actual deliveries we do not necessarily see the need for a complex

methodology and claims process as applies for the calculation ECQ. In the interests of transparency and openness it should be possible to define the main calculations within the UNC.

Nevertheless 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 Network Code 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, will be (perversely) incentivised to withdraw that gas too early for fear of their gas being 'locked in store' in an emergency. Such behaviour could cause or bring forward the declaration of an emergency, 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 an emergency. The values of 30 day System Average Price and SMP Buy price might conservatively be 50p/therm and £5/therm respectively in an emergency. 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 Transco NTS whereas under the new regime he is now expected to pay £5/therm. This is hardly reasonable given one key reason he has invested in storage is to exactly cover this price risk under peak demand conditions.

In effect the current Uniform Network Code 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.

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 emergency and during an actual emergency. 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 an emergency 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 Transco requires 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 seem to forget 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 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.

Proposed Implementation Timetable

Sent to Ofgem requesting Urgency	07/10/2005
Ofgem grant Urgent status	07/10/2005
Workstream consider/amend proposal until	10/10/2005
Urgent Modification Proposal issued for consultation	25/10/2005
Closeout for representations (8 business day consultation)	04/11/2005
FMR issued by Joint Office (+4 business days)	10/11/2005
Panel approve that response reflected appropriately	14/11/2005
Modification Panel Recommendation	14/11/2005
Ofgem decision expected	21/11/2005

Code Concerned, sections and paragraphs

UNC – TPD Sections F and Q
UNC – OAD Section C

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Signature

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