

**Modification Report**  
**Changes to Commercial Arrangements in the event of a Gas Supply Emergency**  
**Modification Reference Number 0502**  
Version 1.0

This Modification Report is made pursuant to Rule 8.9 of the Modification Rules and follows the format required under Rule 8.9.3.

## **1. The Modification Proposal**

The original Modification Proposal was as follows:

The Modification Proposal defines two types of gas supply emergency within the Network Code: a “Gas Deficit Emergency, where inadequate gas supply leads to a national shortfall; and a “Transportation Failure Emergency, where sufficient gas supplies are available to the system but due to a critical transportation constraint it is not possible to meet all demand in a particular area. These definitions will facilitate subsequent changes to Safety Cases and emergency procedures. Transco would determine which type applied in any emergency situation (but not both at once).

The emergency cashout price would be the arithmetic mean of the System Average Prices on the immediately preceding 30 days, multiplied by:

- two for a Gas Deficit Emergency; and
- 0.75 for a Transportation Failure Emergency.

Claims for financial loss (existing paragraph Q4.2.5) would be subject to the following principles:

Allowed costs should be based on an appellant’s total costs and not the cost of an individual source;

Intra-group transfers should be deemed to be made at market price;

Windfall gains” should be netted off wherever possible;

Reasonable administrative / legal costs of making a claim should be allowed, but subsequent costs of pursuing a claim should not be;

These costs should be limited to 5% of the net claim; and

Net income from the value of electricity sold less cost of gas shall be taken into account in the case of a power station “directed on” under PGCA rules.

The Energy & Capacity Workstream recommended to the January 2002 Modification Panel that consultation should proceed on the first five bullet points, with comments invited on the 6th bullet point.

## **2. Transco’s Opinion**

Transco supports implementation of this Modification Proposal as the current emergency arrangements are most relevant to a Gas Deficit Emergency.

Definition of a Transportation Failure Emergency would facilitate the subsequent development of more appropriate arrangements for that scenario. The revised emergency cashout arrangements would:

Better reflect the supply shortfall or surplus for the two emergency types;

Achieve greater consistency between Users' commercial incentives and licence duties; and  
Reduce the number and size of claims for financial loss, and hence the time and effort taken to resolve matters after an emergency.

**3. Extent to which the proposed modification would better facilitate the relevant objectives**

Transco believes that implementation of this Modification Proposal would provide for more cost reflective payments to Users for gas supplied to the System in support of a Gas Supply Emergency. This would further facilitate the securing of effective competition between relevant shippers.

The benefit to Users of receiving more cost reflective payments would in turn better facilitate the efficient discharge of Transco's obligations under its licence in respect of emergencies.

**4. The implications for Transco of implementing the Modification Proposal , including**

**a) implications for the operation of the System:**

In addition to its existing notification requirements, Transco, in its role as Network Emergency Co-ordinator, would be required to identify and notify Shippers of the category of Gas Supply Emergency.

**b) development and capital cost and operating cost implications:**

Transco is not aware of any development costs required to implement this Modification Proposal or of any implications for operating costs.

**c) extent to which it is appropriate for Transco to recover the costs, and proposal for the most appropriate way for Transco to recover the costs:**

Transco anticipates that implementation of this Modification Proposal would not lead to an increase in costs.

**d) analysis of the consequences (if any) this proposal would have on price regulation:**

Transco is not aware of any consequences this proposal would have on price regulation.

**5. The consequence of implementing the Modification Proposal on the level of contractual risk to Transco under the Network Code as modified by the Modification Proposal**

Transco does not anticipate that there would be any consequences on the level of contractual risk to Transco under the Network Code as a result of implementation of this Modification Proposal.

**6. The development implications and other implications for computer systems of Transco and related computer systems of Users**

Transco does not anticipate any development implications for its computer systems or the related systems of Users.

**7. The implications of implementing the Modification Proposal for Users**

Users are less likely to suffer financial loss due to better definition of the type of Gas Supply Emergency and subsequent financial impact.

**8. The implications of implementing the Modification Proposal for Terminal Operators, Consumers, Connected System Operators, Suppliers, producers and, any Non-Network Code Party**

Transco is not aware of any such implications of implementing this Modification Proposal.

**9. Consequences on the legislative and regulatory obligations and contractual relationships of Transco and each User and Non-Network Code Party of implementing the Modification Proposal**

Transco does not anticipate any consequences on the legislative and regulatory obligations and contractual relationships of each User and non-Network Code Party of implementing the Modification Proposal.

**10. Analysis of any advantages or disadvantages of implementation of the Modification Proposal**

**Advantages:**

Clearer and more effective rules and procedures for dealing with emergencies;

Would enable Users to receive more cost reflective cash-out payments in the event of a Gas Supply Emergency.

**Disadvantages:**

Transco has not identified any disadvantages.

**11. Summary of the Representations (to the extent that the import of those representations are not reflected elsewhere in the Modification Report)**

Eight responses were received to the consultation paper.

### Shippers & Suppliers

Shell Gas Direct	SGD
Powergen	PG
TotalFinaElf	TFE
British Gas Trading	BGT
Association of Electricity Producers	AEP
Dynegy	DYN
Scottish & Southern Energy Plc	SSE
Innogy	INN

Four respondents broadly supported the proposal (TFE, PG, SGD & AEP).  
One respondent (BGT) supported the proposal with the exception of the exclusion of the sixth bullet point, which referred to PGCA rules.  
Three respondents did not support the proposal (DYN, SSE & INN).

#### Detailed responses:

##### **a General Principle (including definitions)**

Six respondents (SGD, PG, TFE, BGT, AEP & SSE) stated that they supported the principle of defining two types of gas supply emergency within the Network Code: "Network Gas Supply Emergency Gas Deficit Emergency", where an inadequate gas supply would lead to a national shortfall; and a "Network Gas Supply Emergency Critical Transportation Constraint Emergency", where sufficient gas supplies were available to the system but due to critical transportation constraint it would not be possible to meet all demand in a particular area. INN confirmed support for many of the principles, but requested further clarification on the criteria that Transco, acting as NEC, would use to define the type of emergency.

SSE requested a more specific definition of a Critical Transportation Constraint Emergency and clarification to be provided within the legal text of how Transco would determine the category of emergency.

One respondent (DYN) stated that it did not support the principle, believing that if market arrangements were allowed to continue, Transco would seek to source gas, or curtail gas demand, to alleviate a local emergency. In the event of a Gas Deficit Emergency, a robust financial loss regime would further encourage gas flows to the gas system at such a time as the NEC had suspended market arrangements.

##### **Transco's response :**

**Definition of a Critical Transportation Constraint Emergency:** Sufficient supplies are available but due to a failure of the transportation system it would not be possible to maintain supplies to all firm loads eg a pipe break could lead to interruption of firm supplies across a specific area. The supply shortage scenario rules are relevant to the affected sub-system eg any available supplies need to be maximised and demands curtailed.

Transco believes that the amended legal text provides sufficient definition of the two proposed types of gas supply emergency and further definition is provided within the NEC Safety Case (Final 4 Version 2) which has been circulated to all Users.

Transco would support continuation of the commercial regime in the event of a Critical Transportation Constraint Emergency. As this would, however, constitute a change to the NEC Safety Case it could not be implemented in the timescales proposed for Modification Proposal 0502 but would need to be the subject of a further Network Code Modification Proposal.

Transco would support reconvening the Gas Industry Emergency Committee (GIEC): Commercial Market Implications Work Group (CMIWG) to consider appropriate further development of the commercial regime in the event of a Network Gas Supply Emergency.

## **b Emergency Cash-out Prices**

Five respondents gave qualified support to the proposed emergency cash-out arrangements (SGD, BGT, SSE, TFE & PG). However, one respondent (AEP) stated that it was unnecessary to make such a large distinction between the cash-out prices of the two types of emergency and requested justification for assigning either multiplier to enable it to establish whether the proposed cash-out price would be more cost-reflective.

INN stated that if normal commercial arrangements were not suspended, as under a Critical Transportation Constraint Emergency, then normal cash-out arrangements should apply. Both INN and SSE requested evidence of the appropriateness of 2\* 30-day SAP and 0.75\* 30-day SAP. SSE requested details of the circumstances a shipper could incur this emergency cash-out price.

BGT summarised the rationale in adopting a 30-day SAP instead of a 1 or 7 day SAP and also outlined the rationale for discarding the use of SMP.

DYN queried as to whether the relevant objectives would be furthered if shippers were paid less for cash-out than the existing relevant price (ie arithmetic mean of SAP for the 30 days preceding the emergency).

### **Transco's response**

The CMIWG, one of six sub-groups formed under the GIEC, was charged with considering the implications of suspending the normal commercial arrangements in the Network Code, and the resolution of any consequent problems. The CMIWG's thinking and subsequent recommendations for the emergency cash-out prices and specifically its preference for adopting 2\* 30-day SAP for a supply shortfall and 0.75\* 30-day SAP for loss of load is as follows:

### **Gas Deficit Emergencies: 2\* 30 day SAP**

It represents an increase to the present emergency cash-out price which is considered more representative of "peak demand" conditions. Data was presented to the CMIWG which demonstrated this to be the case.

A cash-out price at this level should reduce the need for shippers to claim additional costs of co-operating with the NEC to maximise gas supplies without creating windfall rents.

The cash-out price applied on one day of an emergency is not likely to make any material difference to a shipper's forward planning (compared with all the other days on which the system is balanced at potentially high prices). It would be unwise to rely on the market failing, even under extreme conditions, since a balance may still be achieved using demand management. On the day of an emergency, shippers should not need the spur of uncapped system emergency prices to co-operate with the NEC in maximising supplies. An emergency cash-out priced based on the System Marginal Price (SMP) applied prior to Stage 2 declaration would potentially encourage demand side bidders to "wait and see" rather than commit their flexibility before it is too late to avert an emergency.

A scenario where demand side reductions are made unilaterally after Stage 2 declaration to exploit the SMP, whilst the NEC in parallel is shedding firm load, could potentially result in under utilisation of available supplies.

Whilst it was acknowledged that a 2\* 30 day SAP cash-out with an appeals process for those Users that felt disadvantaged did not represent a "perfect" solution, the CMIWG believed it represented an incremental improvement to existing arrangements, particularly when set along side other proposals designed to increase reliance on the market balancing mechanisms eg where the emergency is a result of onshore failure.

Transco supports the CMIWG conclusions.

### **Critical Transportation Constraint Emergency: 0.75\* 30-day SAP**

The CMIWG followed similar logic, as explained in BGT's detailed response, which suggested that the long and short cash-out multipliers should be identical, but to discourage over-deliveries and encourage under-deliveries, the multiple should be less than 1, again still with an appeals process for those who feel disadvantaged by this cash-out level and recommended the multiple of 0.75, which Transco supports.

### **c Allowed costs/Windfall gains**

Whilst agreeing that allowed costs should be based upon the appellant's total costs, rather than costs from an individual source, one respondent (AEP) requested further debate to clarify exactly which costs should be included in the total costs.

SGD confirmed that it remained unclear as to how windfall gains would be treated and requested further discussion between the gas and electricity industries. INN confirmed its belief that the interaction between gas and power

markets is a key consideration and would like to see a co-ordinated approach to managing this interaction under an emergency scenario.

PG confirmed its belief that, in principle, the full costs incurred by parties to help minimise the impact of a gas emergency should be paid for by the gas community. Equally, costs to support the electricity system should be paid for by electricity participants.

BGT re-affirmed its view that the sixth bullet point represents a justified restriction for compensation. In the event of the DTI (under the PGCA rules) directing Transco to provide gas for generation at a particular power station where the gas would have been interrupted within normal contractual terms or by firm-load shedding the inclusion of this clause would ensure that any amount of compensation awarded to the company to whom the gas had been allocated, and which ultimately would be smeared across the community, would represent a true net loss to the company. The electricity generated when a power station is directed on would have a value under the Balancing and Settlement Code, and therefore the net income from the value of electricity sold less cost of gas should be regarded as the true net loss. SSE considers that "these issues have not been adequately addressed within either the CMIWG or the Network Code Workstream and urges that further development and debate is required, preferably within a forum that includes representatives of the gas and electricity industries".

#### **Transco's response**

Transco would agree that the Network Code is not designed to address compensation claims where costs and benefits within the Network Code and Balancing and Settlement Code are offset against each other. Transco would, however, be willing to participate in discussions within a forum comprised of representatives of the gas and electricity industries.

#### **d Legal Text**

One respondent (TFE) confirmed its satisfaction with the proposed legal text whilst another (PG) emphasised the need to allow claims for financial loss where a reduction in the gas offtaken from the system reduces the gas deficit. PG suggested an insertion to the legal text under the definition of a Gas Deficit Emergency of "or offtake of gas from the System" and under new clause 4.2.6 (a) "or offtaken from the System" should be inserted after" ... gas delivered to the System".

One respondent (DYN) commented that the legal text does not reflect the restraints on financial loss referred to in the draft report to give added clarity to intra-group transfers and windfall gains.

#### **Transco's response:**

Transco believes that as the key financial losses suffered by a User would be associated with imbalances and the appropriate cash-out price applied to such imbalance, the attached legal text adequately covers Users' responses.



With respect to restraints on claims for financial loss the revised legal text excludes claims applied by any 33 1/3% affiliates. This is consistent with other Network Code provisions for affiliates of companies.

**12. The extent to which the implementation is required to enable Transco to facilitate compliance with safety or other legislation**

Transco is unaware of any such requirement.

**13. The extent to which the implementation is required having regard to any proposed change in the methodology established under Standard Condition 4(5) or the statement furnished by Transco under Standard Condition 4(1) of the Licence**

Transco is unaware of any such requirement.

**14. Programme of works required as a consequence of implementing the Modification Proposal**

Minor changes would be required to NEC procedures. As these changes are minor, it is understood that HSE approval to any revised Safety Case would not be required.

**15. Proposed implementation timetable (including timetable for any necessary information systems changes)**

Transco recommends implementation of this Modification Proposal as soon as possible.

**16. Recommendation concerning the implementation of the Modification Proposal**

Transco recommends that this Modification Proposal be implemented.

**17. Restrictive Trade Practices Act**

If implemented this proposal will constitute an amendment to the Network Code. Accordingly the proposal is subject to the Suspense Clause set out in the attached Annex.

**18. Transco's Proposal**

This Modification Report contains Transco's proposal to modify the Network Code and Transco now seeks direction from the Gas & Electricity Markets Authority in accordance with this report.



## 19. Text

Amend paragraph 1.2.3 to read as follows:

“1.2.3 For the purposes of the Code:

- (a) a “**Network Gas Supply Emergency**” is a network gas supply emergency (as referred to in the NEC Safety Case), namely a Gas Supply Emergency which involves or may involve a loss of pressure in the NTS;
- (b) a “**Network Gas Supply Emergency Gas Deficit Emergency**” is a Network Gas Supply Emergency which arises as a result of deliveries of gas to the System being insufficient for the purpose of meeting demand for gas on the System;
- (c) a “**Network Gas Supply Emergency Critical Transportation Constraint Emergency**” is a Network Gas Supply Emergency which is not a Network Gas Supply Emergency Gas Deficit Emergency; and
- (d) any other Gas Supply Emergency is a “**Local Gas Supply Emergency**” (that is, local gas supply emergency as referred to in the NEC Safety Case).”

Amend paragraph 3.1.1(i) to read as follows:

- “(i) . . . whether it is a Potential Network Gas Supply Emergency or of the stage thereof, and (in the case of a Network Gas Supply Emergency which is not a Potential Network Gas Supply Emergency) whether it is a Network Gas Supply Emergency Gas Deficit Emergency or a Network Gas Supply Emergency Critical Transportation Constraint Emergency, and (in the case of any Gas Supply Emergency), in so far as reasonably practicable, of the nature, extent and expected duration . .  
.”

Amend paragraph 4.2.3 to read as follows:

“4.2.3 For the purposes of this paragraph 4.2 the “**relevant price**” is calculated as:

$$\underline{X * Y}$$

where:

X is the value of the arithmetic mean of the System Average Prices determined under Section F1.2.1 or F1.2.2 but by reference to the 30 Days preceding the Day on which the Network Gas Supply Emergency started; and

Y is, in the case of:

(i) a Network Gas Supply Emergency Gas Deficit Emergency, 2;  
and

(ii) a Network Gas Supply Emergency Critical Transportation Constraint Emergency, 0.75.”

In paragraph 4.2.4 replace the reference to “Section F4.3.3” with “Section F.4.4.3”

Amend paragraph 4.2.5 to read as follows:

“ . . . in respect of the aggregate quantity of gas delivered to the System  
 . . .  
  
(i) . . . amount of such loss (and which may include an amount in respect of administrative and professional costs incurred by the claimant for the purposes of submitting a claim);  
  
(ii) . . . so that it will not suffer such financial loss and in considering the amount which the claimant should be paid the claims reviewer will have regard to the criteria in paragraph 4.2.6;  
  
 . . . ”

Add a new paragraph 4.2.6 to read as follows:

“4.2.6 The criteria referred to in paragraph 4.2.5(ii) are:

- (a) account will only be taken of the claimant's aggregate net costs in relation to the aggregate quantity of gas delivered to the System on the relevant Day;
- (b) the maximum amount that can be taken into account in respect of administrative and professional costs incurred in submitting a claim is an amount equal to the lesser of the actual costs incurred and 5% of the total amount payable (if any);
- (c) no account will be taken of any administrative or professional costs incurred by the claimant following submission of the claim; and
- (d) no claim may be made in respect of any uplift or other charge applied by any 33 1/3% Affiliate of the claimant.

Signed for and on behalf of Transco.

Signature:

**Tim Davis**  
**Head of Regulation NT&T**

Date:

**Gas and Electricity Markets Authority Response:**

In accordance with Condition 9 of the Standard Conditions of the Gas Transporters' Licences dated 21st February 1996 I hereby direct Transco that the above proposal (as contained in Modification Report Reference **0502**, version **1.0** dated **28/02/2002**) be made as a modification to the Network Code.

Signed for and on Behalf of the Gas and Electricity Markets Authority.

Signature:

The Network Code is hereby modified with effect from, in accordance with the proposal as set out in this Modification Report, version **1.0**.

Signature:

**Process Manager - Network Code**  
**Transco**

Date:

## **Annex**

1. Any provision contained in this Agreement or in any arrangement of which this Agreement forms part by virtue of which The Restrictive Trade Practices Act 1976 ("the RTPA"), had it not been repealed, would apply to this Agreement or such arrangement shall not come into effect:
  - (i) if a copy of the Agreement is not provided to the Gas and Electricity Markets Authority ("the Authority") within 28 days of the date on which the Agreement is made; or
  - (ii) if, within 28 days of the provision of the copy, the Authority gives notice in writing, to the party providing it, that he does not approve the Agreement because it does not satisfy the criterion specified in paragraphs 1(6) or 2(3) of the Schedule to The Restrictive Trade Practices (Gas Conveyance and Storage) Order 1996 ("the Order") as appropriateprovided that if the Authority does not so approve the Agreement then Clause 3 shall apply.
2. If the Authority does so approve this Agreement in accordance with the terms of the Order (whether such approval is actual or deemed by effluxion of time) any provision contained in this Agreement or in any arrangement of which this Agreement forms part by virtue of which the RTPA, had it not been repealed, would apply this Agreement or such arrangement shall come into full force and effect on the date of such approval.
3. If the Authority does not approve this Agreement in accordance with the terms of the Order the parties agree to use their best endeavours to discuss with Ofgem any provision (or provisions) contained in this Agreement by virtue of which the RTPA, had it not been repealed, would apply to this Agreement or any arrangement of which this Agreement forms part with a view to modifying such provision (or provisions) as may be necessary to ensure that the Authority would not exercise his right to give notice pursuant to paragraph 1(5)(d)(ii) or 2(2)(b)(ii) of the Order in respect of the Agreement as amended. Such modification having been made, the parties shall provide a copy of the Agreement as modified to the Authority pursuant to Clause 1(i) above for approval in accordance with the terms of the Order.
4. For the purposes of this Clause, "Agreement" includes a variation of or an amendment to an agreement to which any provision of paragraphs 1(1) to (4) in the Schedule to the Order applies.