Modification Report
Revision of the Emergency Cashout Arrangements
Modification Reference Number 0021

Version 3.0

This Modification Report is made pursuant to Rule 7.3 of the Modification Rules and follows the format required under Rule 9.6.

As part of the decision letter on Urgency for this Proposal, Ofgem provided the following timetable:

Sent to Ofgem requesting Urgency	01/06/2005
Ofgem grant Urgent status	02/06/2005
DMR issued for consultation	10/06/2005
Closeout for representations (15 working day consultation)	01/07/2005
FMR issued to Joint Office	08/07/2005
Modification Panel Recommendation	13/07/2005
Ofgem decision expected	22/07/2005

The proposer had suggested the following timetable:

Sent to Ofgem requesting Urgency	01/06/05
Ofgem grant Urgent status	02/06/05
Proposal issued to consultation	03/06/05
Closeout for representations (10 day consultation)	16/06/05
FMR due	30/06/05
Ofgem decision	08/07/05
Implementation date	As directed by Ofgem

1. The Modification Proposal

The Proposer stated that the Modification Proposal sought to:

“1. Amend the setting of the Emergency Cash-Out prices from the prevailing single price of the 30 day average SAP to dual prices set at the point of market suspension:

a. Emergency Cash-Out buy price will be set to the prevailing SMP buy; and
b. Emergency Cash-Out sell price will be set to the prevailing SAP.

Concerns relating to the Emergency Cash-Out (gas) processes were raised within the Ofgem Cash-Out Review Working Group (CORWG). CORWG recognised that the creation of the Storage Safety Monitors and the potential for a Monitor Breach to trigger an emergency had made the potential of a Gas Deficit Emergency (GDE) more predictable; by giving the market additional time to respond and create appropriate price signals leading up to the declaration of a GDE. During CORWG discussions it was noted that the current arrangements might not appropriately incentivise Users to take all actions that could be considered prudent prior to the commencement of an emergency.

One of the principle outcomes of CORWG discussions, to date, was the recognition that appropriate incentives were required to encourage Users to take appropriate actions through which a GDE might be avoided, or, its duration or extent reduced. As a result of the ongoing CORWG review, Transco NTS has considered the next steps that could be taken prior to the coming 2005-2006 Winter.

Any change to the GDE Cash-Out price determination should ensure that Users do not have a financial incentive to withhold gas, i.e. the Cash-Out price for “long” Users should be neutral, and ensure that Users have an appropriate financial incentive to offer demand-side response. Transco NTS believes that the Cash-Out price for “short” Users should reflect the marginal value of demand response. A single Cash-Out price cannot reflect both these values and hence dual Cash-Out pricing may be more appropriate.

Rather than being based on the rolling 30 day SAP, Transco NTS believes that the Emergency Cash-Out buy price should be set to the SMP buy price that is prevailing at the commencement of a GDE. Transco NTS believes that the setting of the Emergency Cash-Out buy price on this basis would provide the Users with signals that are better reflective of the actual market conditions immediately prior to a GDE.

The market should be encouraged to deliver and, where appropriate, provide demand-side response, in order to alleviate the extent and duration of the emergency. For example, where Users take long balance positions as a consequence of their actions to maximise beach deliveries or, by responding to emergency demand reduction notices, then these Users should not be financially disadvantaged. Thus Transco NTS considers that the Cash-Out price for a long-balance position should be set at the SAP price at the time immediately prior to the start of the GDE. Transco NTS believes that if implemented, this Proposal would align the Emergency Cash-Out prices to those market prices prevailing at the commencement of a GDE.

2. Introduction of a new Emergency Interruption Volume title trade and associated ‘trade’ payment

The second element of this Proposal is seeking to assign the volumes of gas associated to GDE interruption actions undertaken by Transco NTS as an effective trade (NBP title transfer) between Transco NTS and the Users. The introduction of an Emergency Interruption Volume (EIV) title trade would ensure that the Users’ imbalance positions prevailing at the time of the GDE were maintained.

To ensure transparency and consistency with other Residual System Balancing actions, emergency interruption during a GDE would represent a market balancing action and thus any payment for such actions should be funded from Energy Balancing Neutrality.

In addition to the EIV trade, it is also proposed that for those occurrences of emergency interruption in a GDE, the Users would receive a level of financial recompense based on the EIV volume(s) multiplied by an Emergency Interruption trade price (rolling 30 day average SAP).

The association of a price with EIV trades would result in a payment from Energy Balancing Neutrality to the User of each Interrupted Supply Point. The EIV would be calculated to offset the gas deficit in a GDE and the net imbalance position of all Users should be equal and opposite to the aggregate imbalance of a new Transco NTS 'Emergency Interruption Manager' account. The net effect on Energy Balancing Neutrality would be a payment equal to the net "interrupted" imbalance at SMP buy and a payment out equal to the net "interrupted" imbalance at the Emergency Interruption trade price. Further analysis is required to establish how the EIV would be allocated to individual Users and Transco NTS intends to provide this during the consultation for this Proposal."

<u>The Proposer stated that:</u>
"Transco NTS is concerned that the current Emergency Cash-out arrangements do not provide the most appropriate incentives on Users to make suitable provision to avoid entering into an emergency situation or, to minimise the extent or duration of such an emergency. This Proposal seeks to provide appropriate incentives on Users in this area.

The Authority has expressed concern in relation to "price sensitive" deliveries to the UK gas market and also questioned whether the current Cash-Out prices during an emergency would provide sufficient incentive to maintain such deliveries.

In order to provide sufficient time for the industry to put in place appropriate arrangements for this coming winter Transco NTS believes that the decision on this Proposal should be provided as a matter of urgency."

Additional Supporting Information
Following the publication of this Proposal, the Proposer, Transco NTS, issued a paper intended to provide additional information which may provide greater clarity in respect of the '**Introduction of a new Emergency Interruption Volume title trade and associated 'trade' payment'.**

<u>Included in this paper Transco NTS expressed the view that,</u>
"In the event of a potential Gas Deficit Emergency (GDE), Emergency Interruption would be used in an attempt to reach a system supply & demand balance and hence the deficit could be removed. This could result in a scenario where a Shipper, which was short of gas going into an emergency, might be brought into balance through the action of the relevant Transporter calling Emergency Interruption. This might result in limited cost targeting of those Shippers that contributed towards a potential emergency, which might weaken the financial incentive to contract for adequate supplies and demand response. Associating a title trade with emergency interruption would, to some extent, correct this lack of cost targeting. If a trade were associated with the volume of the Emergency Interruption, a Shipper that was short prior to Emergency Interruption would be financially exposed at the SMP buy price to the full extent of its pre-emergency short position. A Shipper that was in balance or long prior to Emergency Interruption would retain this imbalance position after Emergency Interruption."

In respect of the interruption trade price and payment Transco states that,
"Emergency Interruption in a potential GDE would represent a market balancing

action and hence it is proposed that any payment for such actions should be funded from energy balancing neutrality.

If Emergency interruption were initiated, a Shipper would no longer receive revenue for gas delivered for that period of interruption from the interrupted sites. Under the prevailing arrangements Emergency Interruption would affect a Shipper's Imbalance and hence it would receive recompense for any lost revenue at a rate based on the 30 day average SAP; 30-day average SAP has therefore been proposed as the most appropriate level for the Emergency Interruption trade price."

In its decision letter regarding urgency Ofgem stated that it considered that, "if the modification proposal were to follow non-urgent procedures, there is a risk that, were the modification proposal to be subsequently implemented, there would be insufficient time for the market to properly consider the impacts of the modification and react accordingly, prior to this coming winter."

2. Extent to which implementation of the proposed modification would better facilitate the relevant objectives

<u>The Proposer stated that:</u>

"That this Proposal, if implemented, would better facilitate the following relevant objective as set out in GT Licence:

In respect of paragraph 1.e): Transco NTS considers that this Proposal might improve, *'the provisions of reasonable and 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 customer'.* The Proposal would ensure that Users continue to be incentivised prior to, and during an emergency, to satisfy their contracted demands.

In respect of paragraph 1.d): Transco NTS anticipates that by targeting cost during an emergency, Users will be encouraged to take appropriate actions through which a GDE might be avoided. Such actions might promote greater and more effective competition between shippers and suppliers."

In its response the Proposer considered that, *"The potential increased cash-out exposure risk for "short" Shippers associated with implementation of the Proposal could be mitigated by the Shipper contracting for a combination of increased supplies and/or increased demand response, and therefore NTS Transco believes that implementation of the Proposal will generate reasonable, cost reflective and economic incentives to promote compliance with the domestic customer supply security standards and hence will better facilitate relevant objective 1(e). Increased Security of Supply should lead to more efficient utilisation of the pipeline system and hence NTS Transco believes that the Proposal will also better facilitate relevant objective 1b); the coordinated, efficient and economical operation of the combined pipeline system."*

CSL stated that, "*UNC0021 (Part 1) will further the relevant objectives and enable the Authority fulfil their function to secure a diverse and viable long term energy supply by enabling a distressed UK network with a suspended market to continue to attract gas through the various interconnections that will be a feature of the GB energy market in the long term. CSL would like to see further analysis* *with regard to the expected response of the other markets and the extent to which other market prices are driven by UK gas prices."*

SGD considered that, ***"****The proposal is potentially discriminatory against those with portfolios without domestic consumers and against those who supply gas on to the system. It acts against effective competition between shippers and relevant suppliers by intervening in market developments aimed at providing security of supply."*

3. The implications of implementing the Modification Proposal on security of supply, operation of the Total System and industry fragmentation

The Proposer stated that it, "*is concerned that the current Emergency Cash-out arrangements do not provide the most appropriate incentives on Users to make suitable provision to avoid entering into an emergency situation or, to minimise the extent or duration of such an emergency. This Proposal seeks to provide appropriate incentives on Users in this area."*

The Proposer stated that, *"the prevailing emergency cash-out arrangements may have an adverse impact on the likelihood of "price sensitive" supplies (interconnector, LNG importation) continuing to be delivered in a potential or actual emergency as the prevailing Marginal prices are defaulted to a 30 day average price." The Proposer believes that, "the prevailing emergency cash-out arrangements also generate little financial incentive to action demand response as the financial exposure created by a 'short position' and a benign cash-out price would be expected to be less than the costs associated with the volume of demand response that would balance a User's portfolio."*

The Proposer believes that, *"end-consumers would value demand response at a level significantly above 30-day average SAP. Given that the potential 1-in-50 annual volumes of demand and the expected supply level for the coming winter indicates a requirement for increased demand-side response, Transco NTS believes that under harsh winter conditions implementation of this Proposal would enhance Shipper and Supplier incentives to meet the Supplier Licence obligation to maintain supplies to domestic users."*

BGT responded that, "*The licence obligations require Suppliers, through their Shippers, to provide for adequate cover of their demand obligations to an appropriate security standard. This is underpinned by appropriate commercial incentives. Once in the situation of a GDE, by definition some provision has failed. To simply increase the exposure of Users does not best serve the assurance of security of supply to consumers."*

No adverse implications in respect of industry fragmentation have been identified.

4. The implications for Transporters and each Transporter of implementing the Modification Proposal , including

a) implications for operation of the System:

In support of this Proposal, the proposer suggested that the "*market should be encouraged to deliver and, where appropriate, provide demand-side response, in order to alleviate the extent and duration of the emergency."* This alleviation could be considered as a beneficial implication for operation of the System.

1. Setting of Emergency Cash-Out Prices - The proposer did not anticipate any adverse implications in respect of the operation of the system.
2. Introduction of a new Emergency Interruption Volume title trade and associated 'trade' payment - The proposer anticipated that additional manpower would be required to facilitate the operation of Systems, which support this change.

In respect of its systems TD advised that the following areas would be affected by the proposed changes:-

"A number of potential system modifications would be required for Transco Distribution to implement the proposer's methodology and these are:

a) *Interruption Manager would require some minor modifications to adapt existing reports and there are costs associated with these modifications;*
b) *SC2004 would require some minor changes to its configuration and reporting process, although we have not had sufficient time to estimate the costs.*

Transco Distribution can make the system and process changes required to meet the proposed implementation date of 1st October 2005, however notification to implement the Modification Proposal must be received prior to the end of July 2005."

Four respondents (SGN, NGN, TD and WWU) concurred with the views expressed by WWU which stated that, "*In terms of the implications of implementing the proposal, initial analysis suggests that the costs likely to incurred by WWU will be immaterial. On this basis we suggest that the DN costs associated with implementation should not be viewed as a barrier to introducing the emergency interruption volume component of the proposal."*

b) development and capital cost and operating cost implications:

Following an external assessment the Proposer concluded that it, "*expected minimal costs to be incurred in adapting current system to provide the information required."*

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

No such cost recovery proposal has been provided by the proposer.

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

No such analysis has been provided.

5. The consequence of implementing the Modification Proposal on the level of contractual risk of each Transporter under the Code as modified by the Modification Proposal

SGN's response offered qualified support for the Modification Proposal as it believes that, *"further work is required to clarify Transporter' obligations in respect of the calculation of the emergency interruption volume for affected supply point on their networks."* SGN noted that the legal drafting provided with this Proposal was 'vague' in terms of information that each transporter would be required to provide to Transco NTS to process EIV trades.

SGN noted that in respect of the contractual arrangement for the application of EIV methodology as, "*it is proposed that the methodology for the calculation would sit outside the UNC, how any disputes regarding the volumes raised ex-post by shippers would be handled, as we appreciate that the emergency interruption volume could have an influence on an individual 'shippers imbalance position'*".

6. The high level indication of the areas of the UK Link System likely to be affected, together with the development implications and other implications for the UK Link Systems and related computer systems of each Transporter and Users

In its response to the Draft Modification Report the Proposer provided the following indications of areas likely to be affected by proposed changes:-

"<u>Emergency Cash-out Price</u>

The Emergency cash-out prices changes can be implemented without any NTS systems impact.

<u>Emergency Interruption Volumes (EIV)</u>

Transco NTS can generate Emergency Interruption Volumes (EIVs) for NTS Supply Points such that an EIV for each User can be calculated and used as the basis for the EIV title trade. The calculation of the User EIVs will be dependent on Transco NTS having access to information regarding the Volumes of Emergency Interruption initiated by each Relevant Transporter. Transco NTS has commissioned an external assessment of the system generally used by other Relevant Transporters in assessing interruption volumes. This assessment concluded that they expected minimal costs to be incurred in adapting current systems to provide the information required. However, Transco NTS would welcome views from other Relevant Transporters in this area.

<u>Emergency Interruption Manager (EIM) Account</u>

The association of a title trade with Emergency Interruption could be facilitated by the creation of an Emergency Interruption Manager (EIM) account on AT Link. This account would be used to generate the title trades on a Shipper aggregated basis. Each Shipper would be deemed to have completed the trade with the EIM entering the disposing trade on behalf of each Shipper. The EIM account would mirror the balancing operator account in that it would not attract imbalance charges and would not be part of the Energy Balancing Smear process."

Four respondents (WWU, NGN, TD and SGN) expressed the view that, "*The enhanced reporting requirements from Interruption Manager, are as stipulated not unduly cost prohibitive, since the information required whilst not currently provided, is available within the system requirements. Such necessary reporting should be available by 1st October 2005, providing implementation of this proposal communicated in the next four weeks".*

7. The implications of implementing the Modification Proposal for Users, including adiministrative and operational costs and level of contractual risk

If implemented this Proposal may introduce incentives which Users may view as significant enough to require putting in place appropriate arrangements and contracts, prior to the coming winter, through which the risk of incurring potential increases in emergency Cash-Out costs may be mitigated.

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

The proposer stated that: "*The Authority has expressed concern in relation to 'price sensitive' deliveries to the UK gas market and also questioned whether the current Cash-Out prices during an emergency would provide sufficient incentive to maintain such deliveries.*" If implemented this Proposal may require Industry parties to put in place appropriate arrangements and contracts prior to the coming winter.

If implemented, this Proposal may increase the appetite for the industry to enter into commercial interruption arrangements, through which demand side response can be placed on the market. Such arrangements would require negotiation between Users and End consumers.

<u>Negotiation of Commercial Interruption Contract</u>

Three respondents (SGD, An End User, TGP) identified issues regarding the renegotiation of commercial interruption contracts.

An End User and SGD noted concerns regarding Urgency, for this Modification Proposal, being granted on the basis that Supplier/End-User contracts for commercial response could be agreed within the "*short time available before the winter*", SGD asserted that, "*the time, resource and effort that would be necessary for commercial response*", had been "*grossly underestimated."* An End User stated that it, "*would not be in a position to renegotiate contracts unless the supplier perceives some benefit in doing so.*" An End User added that, "*if end-users have not included break clauses in the event of a material change* *in underlying business conditions then there will be no opportunity to renegotiate". An End User advised that, "only if there is an obvious risk to the supplier will they be incentivised to come back to the table."*

TGP considered that the Proposer has 'ignored', "*the realities of the customer supplier relationship and therefore brings into question whether the proposal will deliver the objective of timely demand-side management."* TGP added that, "*Many shippers/suppliers would concede that persuading customers of the benefits of including contractual provisions for shipper-initiated interruption has become increasingly difficult and hence in aggregate the level of this response has fallen."* TGP concluded that, "*in the absences of our customers concerns being addressed ……proposal 21 will simply result in customers and Shippers being penalised without still fully addressing demand side response concerns."*

Shared Supply Meter Points (SSMPs)

SSE advised that implementation of the EIV title trade, and associated 'trade' payment, *"will create additional work for the agent at SSMPs in deriving the EIV"* SSE continued*, " To provide information back to the Transporter within an hour."* SSE raised concerns that this timescale was not consistent with that required for Transporters.

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

Where there is an appetite to do so and the parties permitted, by their prevailing contractual arrangements Shipper and End Consumer may wish to renegotiate commercial response contracts.

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

As part of the 'Supporting Information' in relation to this Proposal, the proposer provided the following views regarding Advantages and Disadvantages.

Advantages

- **The proposer stated:** "Introduces appropriate incentives through which Users are encouraged to make suitable provisions to avoid entering into an emergency situation or, minimize the extent or duration of such an emergency."
- **The proposer stated:** "Provides greater incentives for Shippers and Suppliers to manage their own portfolios and supply obligations."
- **The proposer stated:** "Ensure that the correct responsibilities and liabilities are in place to ensure that demand is managed appropriately, therefore may reduce the risk of a Gas Supply Deficit Emergency (GDE), as defined in the Gas Safety (Management) Regulations 1996.
- **The proposer stated:** "Ensures that Users do not have a financial incentive to withhold gas as a result of the GDE cash-out price determination".**The**

proposer considered that: Associating a title trade with Emergency Interruption may, ‘to some extent’, correct the lack of cost targeting experienced under the prevailing UNC Emergency arrangements.
- NGN suggested that, *“by associating a title trade with Emergency Interruption there appears to be an increased likelihood of appropriate cost targeting than under the prevailing UNC arrangements.”*

Disadvantages

- **The proposer stated:** “It is recognised that the proposal adds complexity to the commercial arrangements and that the advantages of the proposal can only be successfully delivered if an appropriate proxy for the volume of Interruption aggregated at a Shipper level can be generated. It is our intention to formulate and present a methodology for calculating the Emergency Interruption volume at the 15th June 2005 Transmission Workstream meeting.”
- Depending on circumstances for that emergencies, SSE believed this Proposal if implemented may increase User exposure to SMP (b) emergency cash out prices with no means by which to mitigate this risk. This could lead to Shipper failure
- Four respondents suggested that in the absence of an appeals process and the inclusion of the EIV methodology in the UNC, disputes may increase at the potential cost of the User and potentially the End consumer..
- EDF believes that in during specific type of emergency events some Users may have a greater advantage in terms of information provision than others. This could be viewed as discriminatory.
- The Proposal may introduce complexity to the emergency regime which may cause a barrier to competition between Users.

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

16 responses have been received.

Scotia Gas Networks	SGN
Chemical Industries Association	CIA
British Gas Trading ltd	BGT
An End User	End User
Northern Gas Networks	NGN
Transco Distribution	TD
Transco NTS	TNTS
RWE Npower plc	RWE
Centrica Storage Limited	CSL
Association of Electricity Producers	AEP
Shell Gas Direct ltd	SGD
Scottish and Southern Energy plc	SSE
EDF Energy	EDF
E.On UK plc	E.On
Total Gas and Power ltd	TGP
Wales and West Utilities	WWU

11 respondents (RWE, CSL, An End User, AEP, SGD, BGT,CIA, EDF, TGP, E.On and SSE) did not support the Modification Proposal.
4 respondents (NGN, WWU, TNTS, TD) provided support for the Modification Proposal.
1 respondent (SGN) provided qualified support.

A General

A.1. Process and Timing

Twelve respondents (CSL, AEP, RWE, SGD, RWE, SSE, An End User, CIA, E.On, EDF, TGP, BGT) expressed concerns regarding the timing and process within which the Modification Proposal was raised. AEP stated that, ***"****Whilst we accept it is important for there to be clarity over these arrangements in advance of the winter, given that some contractual renegotiation may be necessary, we consider that this proposal should have followed normal procedures and should have been discussed with the CORWG and Transmission workstream before being raised."* This view is echoed in the majority of responses to this Proposal. SGD suggested that, *"this proposal has arisen, at least in part, from discussions between Ofgem and NGT."*

Ten respondents (SSE, An End User, CIA, EDF, E.On, TGP, BGT, RWE, SGD, AEP) believed that the Modification Proposal would have benefited from discussion and development, with the industry. CIA responded that the Proposal, "*should have been discussed within the Cash-Out Review Working Group (CORWG) and Transmission workstream before being raised. We believe that this would have resulted in a more robust and fully developed modification than the one that has currently been presented."*

RWE stated that, *"Whilst supporting information has been issued and industry discussion has taken place during the consultation process we believe this is a poor substitute for proper debate and development in advance of the proposal being tabled."*

SSE advised that the consultation process was not helped by the provision of supporting information so late in the consultation process. In particular reference was made to the revised legal text provided "*24 hours before this submission was due in"*.

CSL raised concerns regarding the condensed consultation period, stating that, *"If any unintended consequences are missed due to the 20 calendar days available for consultation then the FMR may not be comprehensive enough for Ofgem make a robust decision in line with their statutory duties. We request that the modification panel reflect this issue in any recommendation"*.

SSE observed that there was, *"a pattern emerging of urgent proposals being put forward (in both the gas and electricity areas) in the late spring/summer which have the potential to profoundly alter the fundamental operation of the market"*. SSE noted that debate was 'curtailed' on these Urgent Proposals with amendments subsequently, "*put forward to improve on these initial 'urgent'* *propositions which could (or should?) have been addressed at an earlier stage had time allowed.***”**

CSL believed*, “that these two parts of the modification would be better considered separately so that the weighting of the separate benefits and drawbacks can be considered separately. A weaker and less clear change to the UNC should not be able to gain implementation on the back of the balance of benefits provided by a stronger and clearer change.”*

A.2. CORWG

TNTS noted that, *“one of the priority areas for the Ofgem Cash-out Review Working Group (CORWG) within the Gas regime is the emergency cash-out process. Transco NTS believe that the creation of the Storage Safety Monitors and the potential for a Safety Monitor Breach to trigger an emergency, coupled with the information provided by Transco NTS regarding the status of these monitors, has made the potential of a Gas Deficit Emergency (GDE) more predictable giving the market more time to respond and create appropriate price signals leading up to the declaration of a GDE. Transco NTS has supported the view raised within the CORWG that the current arrangements might not provide the most appropriate incentive for Users to take all actions that might avoid entering an emergency or minimise its duration.”*

Eight respondents (RWE, SGD, CSL, SSE, AEP, E.On, EDF, BGT) raised concerns that this Proposal did not reflect discussions and developments within CORWG at the point at which the meeting were suspended in April 2005, with no conclusions reached. SSE stated that it was, *"somewhat surprised that the Proposer seems to have come to such definitive conclusions (which warrant an urgent Modification Proposal - 021 - being raised) when neither the CORWG or Ofgem have come to any definitive conclusions with respect to cash-out.”* SSE added that it*, “welcomed the CORWG process as it proceeded in a structured, considered, comprehensive and fully inclusive way to address the issues associated with cash-out in both gas and electricity (as well as the interactions between the two markets)”.*

SGD considered that, *"While NGT states that items were ‘noted’ at these meetings, it does not mean they were agreed”.*

A.3. Justification for Urgency

Three respondents (CSL, SGD, An End User) questioned the appropriateness of this Modification Proposal being processed via an ‘Urgent status’ route. An End User responded that it does not, *"believe that renegotiation of contract should have been used as an argument for urgency”* as An End User believed that for many End-Users *"there will be no opportunity to renegotiate contracts”* or already have, *“contractual arrangements in place for the winter (following advice from ministers for end-users to breakaway from October contracting round to avoid price hikes”.*

A.4. Appropriate consideration of Impacts and Risks

Ten respondents (SSE, An End User, CIA, EDF, E.On, TGP, BGT, RWE, SGD, AEP) echoed the sentiments expressed by EDF which noted that it was, "*concerned that the risks associated with this modification have not been adequately identified or assessed. Therefore, it can not be proven that this modification increases the incentives on Users to balance over current arrangements in a Gas Deficit Emergency (GDE) and therefore can not be proven to further Transco's relevant objectives.*"

An End User noted that*,"Where SMP regimes exist the potential for businesses to be wiped out from one error also exists. This is clearly not the way to ensure an orderly market and takes using "price signals" beyond any sensible application."* An End User continues that it was*, "therefore concerned to see that dual pricing in emergency situations is being considered without a full consideration of why the market rejected this way to proceed previously (and there have been considerable discussions about this since the inception of the Network Code), whether the removal of Top-up gas has led us to this knee-jerk reaction and how to minimise the disjoint when the market moves from normal operation into emergency".*

A.5. Appropriate Incentives

BGT supported the principle that, *"to put in place strong incentives upon all players to avoid entering an emergency situation. However, we believe that the Modification Proposal does not adequately recognise the potential for the prior emergency incentive to become penal should an emergency be declared."*

SSE believed that in was not clear whether this Proposal provided any stronger incentive than the status quo. SSE considered that*, "altering cash-out prices (for the suggested purposes of maximising gas availability) will no better achieve this goal than the current statutory requirements."*

A.5.1. Shipper Incentives

Seven respondents (RWE, CSL, SGD, SSE, EDF, BGT, E.On) consider that were adequate incentives in place, in particular, most of these respondents noted that the forwards price for this winter provided a sufficient incentive to ensure that the User take appropriate actions, which avoid the risks associated with being in a 'short position', as this may mitigate from exposure to forecasted high Cash Out prices this winter.

A.5.2. Shipper/supplier licence obligations

BGT and SSE observed that under Shipper Licence obligations a User is required to provide adequate cover for their demand obligations to an appropriate security standard. SSE stated that, *"altering cash-out prices (for the suggested purposes of maximising gas availability) will no better achieve this goal than the current statutory requirements."*

A.5.3. Increase in un-manageable risk

BGT assert that the combine affect of this Proposal is to increase risk borne by Users. BGT observes that Users may be in a position where, *"no further "commercial"/Shipper interruption is available to them yet when Transco invoke Emergency interruption the demand is shed at prices unreflective of the market. Although the Modification proposal does impact upon the commercial position of various players, by increasing the incentive to balance prior to, and* *therefore to avoid an emergency, it does not have any material effect upon the quantity of gas available once a gas emergency is declared yet exposes Users to increased risk".*

A.6. Disputes and Appeals process

Four respondents (SSE, EDF, CIA, CSL) raised concern regarding the absence of appeal provisions, for both Dual Cashout and the EIV, within the UNC. CIA sought clarification regarding**,** "*as to how any disputes over the EIV will be resolved. This is particularly important given that an inaccurate calculation could be detrimental to a shipper that was in fact balanced prior to a GDE being called, and who would ultimately pass these costs onto the consumer."*

A.7. Transco Incentives

CSL suggested that, "*There may also be some complex interactions between Transco's incentives which the short consultation period has not afforded sufficient time to analyse".*

A.7.1. Transco NTS contracting for insurance policy or forward contracts

Three respondents (SGD, An End User, TGP) considered that as NGT, in its role as residual balancer and System Operator respectively, should either contract forward for Balancing actions or manage an insurance policy on behalf of the Users.

TGP suggested the Transco NTS should, *"take the lead in offering a standard demand side contract and replicate the success of transporter agreed demand-side services in the electricity market".*

SGD believed that*, "This would provide the market certainty that many industrial customers would like in order to enter into demand-side contracts while giving NGT the certainty of turn down".*

An End User considered that, **"***The most efficient way of managing the market in the absence of sophisticated market products is for the SO to manage an insurance policy on behalf of the whole industry".*

A.8. Legal text Clarity

Four respondents (SSE, E.On, EDF, SGN, SGN) requested clarity in respect of the draft legal text provided.

EDF stated that, **"***it is unclear whether Transco can take Market Balancing Actions in a GDE with section 3.2.2 of the UNC prohibiting this (but we understand the new legal text which Transco raised at the last hour addresses this issue). However, it is still unclear as to a supplier's obligations under an emergency which increases suppliers risks in a GDE. Transco would therefore have to re-educate suppliers, and all shippers as to the repercussions and risks associated with this proposal but we believe there is insufficient time before this winter, or this summer for that fact where the last major demand-side interruptions occurred."*

Two respondents (SSE, SGN) noted that the legal text does take account of the new responsibilities shared by Transporters following the recent DN sale. The general view from Users that responded to this issue was that these change should be reflect within the draft legal text for this Proposal.

TNTS provided further legal text clarification within its response and stated that, *"During the consultation period Transco NTS received requests for clarification of a number of areas of the Proposal and associated proposed legal text. The areas of clarification sought were:*

- *Is the Emergency Interruption trade a Market Transaction - and specifically does it therefore feed into System Clearing Charges*
- *What type of Emergency would the Proposal apply to - i.e. does it include a Critical Transportation Constraint emergency*
- *Are such trades treated the same as other types of trades at the point of market suspension.*

In an attempt to address these requests NGT have reassessed the legal text with a view to adding further clarity. Transco NTS consider that the changes made to the text do not change the nature or intent of the Proposal but rather add clarity to the treatment of the trade in relation to charges. The revised legal text provided with this representation highlights the changes made."

A.9. Security of Supply

TNTS recognised that, *"the prevailing emergency cash-out arrangements may have an adverse impact on the likelihood of "price sensitive" supplies (interconnector, LNG importation) continuing to be delivered in a potential or actual emergency as the prevailing Marginal prices are defaulted to a 30 day average price.*

Transco NTS believes that the prevailing emergency cash-out arrangements also generate little financial incentive to action demand response as the financial exposure created by a "short position" and a benign cash-out price would be expected to be less than the costs associated with the volume of demand response that would balance a User's portfolio.

Transco NTS believes that end-consumers would value demand response at a level significantly above 30-day average SAP. Given that the potential 1-in-50 annual volumes of demand and the expected supply level for the coming winter indicates a requirement for increased demand-side response, Transco NTS believes that under harsh winter conditions implementation of this Proposal would enhance Shipper and Supplier incentives to meet the Supplier Licence obligation to maintain supplies to domestic users."

SGD advised that, *"Shell takes its security of supply responsibilities very seriously. SGD has been working with its customers to develop responses to the high market prices and to ensure that we meet our safety obligations. We do not consider that this proposal will improve security of supply for this winter, and may undermine activities aimed at achieving this."*

SGD did not believe that the Proposal presented any beneficial effect on the security of supply for domestic consumers. SGD considered that this Modification Proposal does not distinguish between relevant suppliers and others and as such could be viewed as discriminatory by imposing risk and change on charges on non-domestic shippers.

A.10. Market Suspension in Stage 1 emergency

BGT expressed concerns about the point at which the Market becomes suspended and stated that, "The suspension limits Users ability to respond and take appropriate actions to balance. The suspension of the OCM market may also lead to distortions and absence of signals, which may be misleading."

A.11. Impact on price and forward market for Winter 2005/6

Three respondents (EDF, An End User, SGD) highlight concerns regarding the influence this Proposal may have on prices in the Forwards market for Winter 2005/06. EDF stated that, **"***The UK gas market will be entering the tightest supply and demand position this winter and market prices have soared off the back of potential demand-side interruptions. The raising of modifications relating to "emergency situations" which have not been properly discussed with the industry can only serve to spook the market and prices even further for this winter".*

SGD expressed concerns relating to the Proposer seeking urgent status for this Proposal, which Ofgem has granted. It stated that, "*By doing this, Ofgem and NGT are suggesting to the market that they consider that there is a potential for the market to fail this winter. This may be contributing to the sentiment reflected in the forward prices".*

CSL believes that, "*current forward prices for winter '05 provide sufficient incentives on system participants to make appropriate arrangements without further market intervention".*

A.12. Long term energy supplies to UK (interconnectors, LNG importation etc)

TNTS stated that it, *"has also supported the view, raised within the CORWG, that the current arrangements might have an adverse impact on so called "price sensitive" supplies such as flows into the system via Interconnectors and LNG importation. Any reduction in market prices resulting from a reduction in cash-out exposure in a GDE may result in price sensitive supplies being diverted from the UK to other markets where market prices were higher leading to an increase in the gas deficit and hence potentially exacerbating the emergency."*

CSL stated that, "*UNC0021 (Part 1) will further the relevant objectives and enable the Authority fulfil their function to secure a diverse and viable long term energy supply by enabling a distressed UK network with a suspended market to continue to attract gas through the various interconnections that will be a feature of the GB energy market in the long term. CSL would like to see further analysis with regard to the expected response of the other markets and the extent to which other market prices are driven by UK gas prices."*

SGD noted that, *"Parties that may need to be incentivised are those who could bring gas through the Interconnector or from Norway. There may be reluctance to make commitments due to the low price that they would receive should the market be suspended. Our reading of this proposal is that they would be under-rewarded in an emergency. If the party had sold gas into the market, i.e. to Transco through the OCM, then the strike price may be much higher than what they will receive through the prevailing SAP. This makes offering such gas to the market financially risky yet getting this gas into the system is exactly the behaviour to be encouraged".*

An End User stated that it did not believe that, *"moving to SMP buy cash-out for shippers who are short in circumstances where the system is short would necessarily ensure more continental gas comes through, at least not until more liberalisation takes place in Europe. Beyond a certain level it does not matter if a price signal is very high or exceptionally high – it does not conjure up more gas and only adds to the risk faced by market participants."*

E.On raised issues relating to interconnector reverse flows when the emergency has been initiated and the prevailing 30 day average SAP applied. E.On noted that this had been considered as an argument for a penal cash out buy price. E.On agreed that this matter should be addressed, but not through the proposed changes in this Modification Proposal.

A.13. Electricity comparisons and impacts

BGT recognised that although the application of a SMP (buy) for cash out of a short position provided a strong incentive for Users to balance, *"in the power regime, the issue of cashout prices in an emergency was considered in Modification Proposal P135. This was rejected by Ofgem. In their decision letter Ofgem raised concerns about the possibility of a small volume setting the price, that volume being taken for system reasons could set the price and the potential for manipulation. Quoting the P135 decision letter "Ofgem continues to have concerns that setting Energy Imbalance Prices based on a single action has the potential to distort these prices." BGT believe the concerns expressed by Ofgem remain valid and read across into the gas market".*

A.14. Types of Emergency

SSE advised that it should be recognised that depending on circumstances emergencies may vary and have different impacts on the industry. SSE noted that it, "Some are 'progressive' in nature; for example, a general deterioration in the (forecasted) weather situation; whilst others are 'sudden'; such as an explosion (caused perhaps accidentally or deliberately by those seeking to cause harm)." SSE considered that for a 'progressive' emergency it maybe that the market could react as envisaged by this Modification Proposal. However for a 'sudden' event SSE suggested that, *"there will be little, if anything, the market can do to prevent a GDE occurring. In this situation it seems both excessively harsh, and counter to natural justice, to penalise certain market participants by way of the prevailing SMP and yet also penalise those that are making a positive contribution by only paying them the 30 day SAP.*"

A.15. Duration of Emergency

BGT raised concern regarding the potential duration of the emergency when a safety monitor breach has been triggered. BGT stated that, *"it may be difficult to lift the emergency condition if it had been caused by a breach of the short-term (LNG) storage monitor. We suggest that the issue of recovery from an emergency, if caused by a breach of the short-term safety monitor, requires further consideration."*

B. **Amend the setting of the Emergency Cash-Out prices from the prevailing single price of the 30 day average SAP to dual prices set at the point of market suspension**

B.1. Appropriate Relevant Prices

B.1.1. Consideration of Appropriate Relevant Emergency cash-out Prices (Question 1a)

One (SSE) respondent did not believe that the relevant emergency Cash Out prices were appropriate.

One (CIA) respondent believed that the relevant emergency Cash Out prices were potentially appropriate.

SSE considered that when applying the proposed relevant prices in a 'sudden' GDE the prices, *"are predicated on the assumption that participants are realistically able to react to these incentives".*

RWE noted that although at the dual price provided a strong incentive on parties to avoid being short in the run upto market suspension once the market is suspended parties may have little or no ability to trade out their imbalance. RWE concluded that, "*Consequently, parties that are short may be exposed to a high and unknown cost of imbalance".*

CIA considered that, *"The setting of the Emergency cash-out buy price at the prevailing System Marginal Price (SMP) buy, and the sell price at prevailing System Average Price (SAP) are potentially appropriate relevant prices. We believe that under the current regime setting the Emergency Cash-Out price at the 30-day SAP average does not encourage shippers to ensure they are balanced before entering an emergency."*

B.1.2. Setting the Emergency Cashout (sell) price

CSL considers that, "Setting the SMP sell price to SAP should, all other things being equal, encourage shippers to overflow against their portfolio position. CSL maintains the view that the market is capable of fulfilling this function more efficiently under the existing mechanisms."

B.1.3. Neutral price

Four respondents (E.ON, RWE, SSE, CSL) believed that the emergency price should remain neutral. SSE recalled that the general consensus of CORWG was that, *"the group recognised the importance of having a neutral price when the market is effectively 'Broken'."* SSE considered that the Proposer was seeking to introduce a "*Penal mechanism"* during such conditions.

CSL considered, *"an advantage of neutral cash out is that it allows the decision by Transco NTS to invoke an emergency to be free from other influences. If this proposal is implemented then it will become very difficult for Transco NTS to verify to the Authorities that every action was taken and the opportunity for the marginal therm to be delivered duly given. By imposing SMP buy on all short shippers once the emergency is called Transco NTS will have to justify that the marginal cash out price was economically and efficiently set e.g. Is it the last LNG therm or the realisation that all remaining demand is firm and indifferent to further price escalation? This modification will introduce a new ability for Transco to manage demand in an economic and efficient manner without consideration for how this ability would be wielded. CSL believes that it is unwise to introduce such a mechanism without also introducing a strong framework for controlling the trigger conditions for when it would be used and the process which would be applied."*

B.1.4. Consideration of Increased Risk associated to exposure to prevailing SMP price (Question 2b)

Two respondents (SSE, RWE) believed that there was an increase in risk of significant exposure to SMP (b) price in which under certain circumstances Users would be unable to mitigate from the risk. RWE believed that, *"there may be a greater risk of shipper failure"*.

AEP responded that with, "*limited information on after the day allocation at beach entry points during the day and may find themselves unexpectedly short position even though on the day they acted on the best information available and had taken all reasonable steps to secure gas supplies to their customers."*

B.2. Appropriate level of incentives to ensure emergency averted (Question 1c)

Two respondents (SSE, AEP) did not consider that such a mechanism would incentivise the Transporters and Users to avert a GDE. SSE stated that, *"Whilst we accept that in certain limited circumstances this proposal might provide greater incentives on Shippers to take actions, this does depend on the speed at which GDE happens"*. SSE maintained the view that during 'sudden' emergencies, "*Users and Transporters may be unable to react to event"*.

Five respondents (CIA, EDF, TD, RWE, TNTS) believed that the introduction of a dual cash-out price will encourage both Users and Transporters to ensure they take all possible steps to ensure they are in-balance before an emergency is called.

RWE stated that the effect of the SMP (b) Cash out price, *"may be mitigated to some extent since the cost of the actions are reflected in neutrality payments, although a parties ability to anticipate any neutrality benefit is severely challenging."* RWE suggested that, *"it may be more appropriate to reflect the cost in the relevant transporter's system operator incentive scheme"*.

AEP stated that, “The dual price cashout only enhances the incentives on shippers when there is time for the market to respond and the stages of an emergency proceed sequentially.”

B.2.1. Financial Incentives

TNTS believed that “*that any change to the GDE cash-out price determination should seek to ensure that Users do not have a financial incentive to withhold gas from the system, i.e. the cash-out price for “long” Shippers should be comparable to, or lower than pre-emergency cash-out, but at the same time it should also ensure that Shippers do not have a financial incentive to withhold demand response, i.e. the cash-out price for “short” Shippers should reflect the full or marginal value of securing demand response. Transco NTS considers that these dual incentive properties can only be delivered via dual cash-out prices.*

SGD considered it, *"Shell and other companies with upstream interests have an interest in ensuring that the gas system remains secure and are well aware of the political pressure to ensure a safe system this winter. It is offensive to suggest that there would be any party would have “a financial incentive to withhold gas” and such a statement suggests a poor understanding the financial and reputational incentives such parties have. We would be interested in any evidence that NGT has to support such a statement. This has been discussed repeatedly through workstreams etc and we are disappointed that this has not been understood by NGT and perhaps not by Ofgem.”*

B.2.2. Discrimination between Users

EDF believed that there was merit in moving towards dual cash out prices, **“***However it is not clear what the consequences are for all types of shippers as the risks are greater for some over others, especially considering there is no claims process associated with this proposal. For example, before an emergency the National Emergency Co-ordinator (NEC) will contact offshore parties to enquire about all possible increases in gas flows into the NTS giving shipper-producers a head start in the market that an emergency may be imminent. This situation may be inevitable and happen regardless of which cashout arrangements are in place but where down stream shippers are competitively disadvantaged then there should not be extreme dual cashout prices. The impact of extreme cashout prices during an emergency become even more unjustified when an emergency arises quickly as a result of a major supply failure or terrorist act for example. The original cashout price of 30 days average SAP was agreed by all as the fairest and most reflective price for all Users so that no particular type of party was unduly disadvantaged as any party which had incurred extra costs by bringing gas onto the system at a lower cost could claim for compensation afterwards.***”**

B.3. Dual Cashout strengthens incentives

RWE believed that, *“A dual emergency cash out price may strengthen the incentives on shippers to avoid an emergency situation arising to the extent they are able to take effective action that adjusts their balance position in the run up to an emergency. However in the event they are not (for example due to a catastrophic failure of a beach terminal), or once in an emergency situation* *where they are required to comply with the directions of the NEC, dual cash out prices may significantly increase shipper exposure".* RWE believed that User could be exposed to SMP(b) for indefinite and unpredictable periods during an emergency event which may result in Shipper failure.

CIA supported Transco's view that the introduction of the dual emergency Cashout price with a Cash Out 'buy' price of SMP buy may, *"also provide a clear signal to both consumers and shipper as to the value of interruption before a GDE is called. Many of our members report that currently they are not incentivised to take a shipper nominated interruptible contract, and so at a time of tight supply/demand some members are moving to firm supply contracts."*

B.4. Consistency with Electricity
SSE noted that a similar Proposal had been raised within the Electricity industry (Balancing and Settlement Code Modification Proposal P173. SSE questioned whether NGT is being consistent in its argument on the matter of emergency cash out arrangements between the two industries.

B.5. Information provision
SSE suggested that some Users may be at a disadvantage of knowing their actual position on the day due to the extreme price and the associated volumes that they could be exposed to. SSE stated that, *"Without this data they will find it extremely difficult within the day to accurately quantify their true exposure position."* SSE suggested that uncertainty of it credit position could affect it's ability to participate on the OCM.

B.6. Neutrality
BGT noted that the effect of neutrality may have a bearing upon behaviour, *"With the SMP(B) to daily SAP differential, it is assumed that this would be a net contribution to neutrality. Therefore, Users will also experience a further effect of this contribution."*

C. **<u>Introduction of a new Emergency Interruption Volume title trade and associated 'trade' payment</u>**

C.1. General

C.1.1. Impact on prices
An End User expressed concerns that, *"this proposed modification would force the general level of prices higher if implemented. This would occur through all suppliers being forced to go out and contract for more volume of gas in every period to cover peak demands at critical periods".*

C.1.2. End Consumer Engagement
An End User asserted that the development of the Modification Proposal, *"lacked industry input and will open the way to major appeals if an emergency does occur as the crucial players in this, interruptible end-users, have not been involved in the modification's development."* An End User advised that it would, *"welcome further involvement in the interruption process and the opportunity to achieve high rewards for interrupting and placing offers on the*

OCM, and yet we find these arrangements unclear, so that we will remain unsure as to what the status of the market is".

C.1.3. Renegotiation of Commercial Interruption contracts

Three respondents (SGD, An End User, SSE, TGP) considered that this Proposal underestimates timescale required for contract negotiation. This is discussed further in section 8 of the Final Modification Report.

SGD noted that it**,** *"has discussed demand side response with consumers, including with firm customers. Taking forward this activity could improve security of supply but implementation of this proposal would take resources away from pursuing these arrangements. It must be noted that many customers choose transportation-only interruption terms. Part of this decision is their perception that risk of interruption for emergency purposes is low. The customer can also choose to have shipper interruption. Our experience is that many on transportation-only terms are not interested in other options: NGT wants to intervene in the customers' decision-making process. All consumers' interests should be considered in developing proposals such as these."*

C.1.4. Linkage with other Modification Proposal

AEP observed that this aspect of the Proposal indicates, *"a linkage with UNC modification 13/13a that sought to remove Transco's rights to interrupt sites for supply / demand reasons. If this proposal were implemented then it would be legitimate to question whether sites that are interruptible should be interrupted for supply / demand reasons at all, even in an emergency, and whether there is a justification for a different approach in gas from that in electricity that would allow proxy constraint interruption to be included in cashout prices."*

C.2. EIV methodology

C.2.1. Clarity on the methodology relating to the calculation of EIV would assist the development of this Proposal and views on this methodology are requested.(Question (a))

Two respondents (CIA, TD) supported the calculation of EIV methodology.

CIA supported, *"the proposed methodology for calculating emergency interrupted volume (EIV) and believe the Offtake Profile Notice (OPN) represents the best proxy for this volume. However we seek clarity as to the methodology that will be employed when no OPN is available and the site has been interrupted for a period longer than 21 days".*

Four respondents (RWE, BGT, AEP, SSE) responded that the EIV methodology lacked clarity highlighting concerns that it was unclear how the mechanism would work in practice.

AEP stated that the methodology appeared 'reasonable' but details were required regarding communication of the EIV.

RWE responded that, "*It is important that a reasonable estimate is created based on returning a party to the imbalance that would have prevailed prior to the emergency period. Transco's methodology, as currently understood, would appear to provide the basis for creating such an estimate. However, as stated above there is still considerable uncertainty how this will be applied for partial gas days, and how it interacts with shipper interruption".*

RWE recognised that EIV calculation methodology could only ever be an approximation for the gas that would have been taken by the emergency interrupted site, however RWE expressed concerns that Users would have, "*little transparency over the calculated volumes due to the fact that there will be one EIV trade for their entire portfolio."*

BGT stated that the method of assessment of this volume was the "subject of some uncertainty", "..where errors *could lead to a significant change to a users exposure to cashout at marginal price. This could be a benefit or detriment to the User but is entirely outside their control."*

SSE stated that it was not clear if the methodology for calculating the EIV was based on day-ahead or within-day data, or over historical data.

C.2.2. Inclusion of EIV Methodology in the UNC

Four respondents (SSE, SGN, TD, WWU, AEP) believed that the EIV methodology should be included in the UNC. SSE considered that, *"it should be included, rather than being left to the Transporters discretion".*

SGN believed that it would be unclear to see, *"how disputes regarding the volumes raised ex-post by Shippers would be handled, in the absence of the methodology being include in the UNC."*

C.3. EIV trade

CIA welcomed the introduction of the EIV Trade, *"as it will ensure that a shipper that was not balanced before a GDE would not benefit from Transco actions in an emergency."*

TNTS considered that, *"If Emergency Interruption were initiated, a Shipper would no longer receive revenue from the relevant end consumer for gas delivered for that period of interruption from the interrupted sites. Under the prevailing arrangements Emergency Interruption would affect a Shipper's Imbalance and hence it would receive recompense for any lost revenue through the cashout process or through trading on any surplus gas. Transco NTS believes that for the proposes of this part of the Proposal 30-day average SAP is an appropriate level of payment for the Emergency Interruption trade price. A higher price might disincentives a Shipper from entering into a commercial interruption arrangement with end consumers where as a lower price may not provide sufficient recompense to Shippers for the cost of the gas sold to the Residual System Balancer as a result of the Emergency Interruption related trade and lost profit from the sale of gas to the interrupted end consumer.*

It is not intended that Transco NTS Emergency Interruption action will impact the order in which Market Balancing Actions are taken whilst the market remains open. Once a potential or actual Emergency has been declared, Transco NTS will be acting under the instruction of the NEC and will use all available tools, OCM or otherwise to manage the potential or actual emergency in accordance with our licence obligations and our GSMR obligations."

C.3.1. Considerations regarding whether the 30 day average SAP sets an appropriate 'relevant price' for trading the emergency interruption (Question (b))

Three respondents (AEP, RWE, TD) supported the 'relevant price' being set a 30 day average SAP.

AEP considered that the 30 day average price seemed reasonable.

RWE supported in principle of what this change was seeking to achieve, namely that Users in short position do not financially benefit from emergency interruption. RWE noted that the EIV volume in Cash Out was SMP (b) and considered that, *"the 30 day average SAP was adequate recompense to parties for the average portfolio cost of gas purchased prior to the emergency."*

RWE suggested that, "*This may also lead shippers to interrupt sites or offer demand side response sooner than they might otherwise have done under the existing arrangements"*.

BGT considered that applying a value of 30 day average SAP price to the EIV trade, **"***removes the EIV from the User at a price well below the potential value on that day."* BGT believed that, *"This position may have perverse impact upon User actions as an emergency situation develops"*

CIA questioned, **"***whether the 30-day average SAP is an appropriate price for the EIV trade. If this price is set to provide an adequate level of compensation to shippers then it is to be supported, however if it is also designed to encourage the supply of gas over the interconnector, then we are unsure as to how this mechanism will work."*

SSE advised that, *"it appreciated that the Proposal was attempting to achieve a neutral price in respect of the emergency interruption.*

SSE goes on to query the inclusion of such trade values in the emergency Cash Out calculation.

It should be note that as part of the Proposer's Revised Legal drafting for this Proposal, issued on the 30 June 2005, a clarification was provided which advised that EIV trades would not be included in the emergency Cash Out calculation.

C.3.2. Interruption Payment

TNTS believed, *"that Emergency Interruption in a potential GDE is a proxy for a Residual System Balancer national supply and demand balancing action and* *therefore it is appropriate that charges for such actions should be funded from energy balancing neutrality."*

C.4. Impact on User

C.4.1. Consideration of anticipated increases in risk associated with applying the EIV to the User imbalance and consideration of any issues relating to the ability to avoid such risks. (Question 2C)

SSE believed that the risks will increase "*significantly"* and, *"in certain circumstances, parties unable to avoid such risks."*

RWE noted that the methodology required to derive the EIV should be 'open and transparent' as this would allow parties to challenge and mutually agree the volume calculations.

AEP stated that, *"From a shipper perspective this risk appears almost unmanageable as it has no role in determining the EIV. From a customer perspective the risk will depend on whether any costs are passed on, customers might be able to manage the risk by providing accurate OPNs."*

C.4.2. Trade Information Provision

RWE and SSE noted concerns regarding transparency of EIV trade volumes. SSE noted that the legal text infers one aggregate EIV trade per User per day. SSE questioned, *"how Users will be able to validate the trades made against his portfolio for reconciliation purposes."* SSE believed that a User needs to see each EIV for each supply point.

RWE suggested that although it would be 'unreasonable' to expect such information during an emergency situation, it was not unreasonable for such information to be made available at a later date.

RWE raised concerns that the emergency interruption Shipper Notification process may become more complicated and there was lack of clarity as to how the interruption notice period would be treated.

C.4.3. Billing of EIV trades

RWE questioned whether billing of EIV trades would necessitate changes to the invoice file formats and Shipper reconciliation systems/processes.

In response to this question NGT high level impact assessment indicated that no changes to invoicing file formats would be required for this change.

C.5. Examples provided by the Proposer detailing examples of a User Emergency interrupted from a Balanced, Long and Short position.(Question d)

Impact – Shipper Imbalance: Long/Short/Balanced

The following table demonstrates how Transco NTS believes Shippers would be impacted by the implementation of the Proposal given different levels of imbalance.

Shipper Imbalance	Impact of Prevailing Arrangements	Impact of Proposed Arrangements
Short	Shippers with a Short imbalance would face cash-out exposure at the relevant SMP price. Emergency interruption might reduce or remove the imbalance position and hence the cash-out exposure would be reduced or removed.	Imbalance position is unaffected by the Emergency Interruption. Shippers with a Short imbalance would face cash-out exposure at the final marginal buy price on the day. Shippers would receive a payment for the EIV based on 30-day average SAP.
Balanced	Shippers with a balanced portfolio would face no cash-out exposure. Emergency interruption would create a long imbalance position equal to the EIV and hence a cash-out payment would result or the Shipper could trade away this surplus position.	Imbalance position is unaffected by the Emergency interruption. Shippers would receive a payment for the EIV based on 30-day average SAP.
Long	Shippers with a Long imbalance would receive a cash-out payment at the relevant SMP price. Emergency interruption might increase the imbalance by the EIV and hence the cash-out payment would increase or the Shipper could trade away this surplus position.	Imbalance position is unaffected by the Emergency interruption. Shippers with a Long imbalance would face cash-out exposure at the final marginal buy price on the day. Shippers would receive a payment for the EIV based on 30-day average SAP.

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

Implementation is not required for this purpose.

13. The extent to which the implementation is required having regard to any proposed change in the methodology established under paragraph 5 of Condition A4 or the statement furnished by each Transporter under paragraph 1 of Condition 4 of the Transporter's Licence

Implementation is not required having regard to any such proposed change.

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

The Proposer has not provided a programme of works.

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

The Proposer has suggested that this Proposal should be implemented by 1 September 2005.

Three Transporter (TD, SGN, NGN) indicated that the programme of works required to support this Proposal, if implemented, could be completed in time for 1 October 2005.

16. Implications of implementing this Modification Proposal upon existing Code Standards of Service

No such implications have been identified.

17. Recommendation regarding implementation of this Modification Proposal and the number of votes of the Modification Panel

At the Modification Panel meeting held on 19 July 2005, of the nine Voting Members present, capable of casting ten votes, three votes were cast in favour of implementing this Modification Proposal. Therefore the Panel did not determine to recommend implementation of the Proposal.

18. Transporter's Proposal

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

19. Text

The Proposer has provided the following suggested draft legal text:

Modification Proposal Number 0021
"Revision of the Emergency Cashout Arrangements"
Legal text for Draft Modification Report

The text provided is legal text which, combines draft legal text provided as part of Draft Modification Report '0021' and the 'Revision of the Emergency Cashout Arrangements Legal text for Draft Modification Report 0021', issued on the 30 June 2005.

1. Setting of Emergency Cash-Out prices:

UNC – TPD section Q 4.2.3.

Amend paragraph Q4.2.3 to read as follows:

"For the purposes of this paragraph 4.2 ~~the 'relevant price' is~~:

(a) the "relevant price" In respect of paragraph 4.2.2 (a) is the System Average Price determined under Section F1.2.1 or F1.2.2; and

(b) the "relevant price" in respect of paragraph 4.2.2 (b) is the System Marginal Buy Price as determined under Section F1.2.1 (a) ~~the Value of the arithmetic mean of the System Average Prices determined under Section F1.2.1 or F1.2.2~~

In each case ~~but~~ by reference to the ~~30 days preceding the~~ Day on which the Network Code Gas Supply Emergency Gas Deficit Emergency started"

2. Emergency Interruption Volume title trade and associated payment:
UNC – TPD section Q.

Amend paragraph 3.4.5 to read as follows:

"3.4.5 The relevant provisions of G6 will apply for the purposes of Interruption in a Gas Supply Emergency (including a Potential Network Gas Emergency) or Local Gas Supply Emergency, except that:

(a) the Transporter shall not be required to give 5 hours' notice of Interruption but may require Interruption as soon as practicable following the Transporter's Interruption Notice;

(b) the User may not request an alteration pursuant to Section G 6.8.2 to the Supply Points to be Interrupted;

(c) any Day or Days of Interruption pursuant to this Section Q shall not count towards the use of the Interruption Allowance under Section G 6.7.5;

(d) the provisions of Section G 6.9 (other than Section G 6.9.2(a)) in respect of a failure to Interrupt shall not apply.

In addition, the provisions of paragraph 6 of this Section Q shall apply following Emergency Interruption."

Amend paragraph 4.2.2 to read as follows:

"4.2.2 In respect of each Day during a network gas Supply Emergency Gas Deficit Emergency:

(a) Transco NTS shall pay to each User who delivered on a Day more gas to the Total System than it offtook on such Day an amount determined as the User's Daily Imbalance multiplied by the relevant price, subject to paragraph 4.2.5;

(b) each User who offtook on a Day more gas from the Total System than it delivered on such Day shall pay to Transco NTS an amount determined as the User's Daily Imbalance multiplied by the relevant price.

For the purposes of this paragraph 4.2.2, and pursuant to the provisions of paragraph 6.2.1, a User's Daily Imbalance shall include that User's Emergency Interruption Volume."

Insert the following as new paragraph 6:

"6. EMERGENCY INTERRUPTION

6.1 Definitions

6.1.1 For the purposes of the Code:

(a) "**Emergency Interruption**" means Interruption due to a Network Gas Supply Emergency (including a Potential Network Gas Supply Emergency) other than a Network Gas Supply Emergency Critical Transportation Constraint Emergency or a Potential Network Gas Supply Emergency Critical Transportation Constraint Emergency;

(b) "**Emergency Interruption Trade Price**" means 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 Emergency Interruption occurred; and

(c) "**Emergency Interruption Volume**" means, in respect of a User, the aggregate quantity of gas (in kWh) which Transco NTS reasonably estimates that User would have offtaken from the Total System at System Exit Points in respect of which Emergency Interruption had been called but for the fact that Emergency Interruption had occurred at those System Exit Points.

6.2 Emergency Interruption Trade Arrangements

6.2.1 On any day in which Emergency Interruption is called at one or more System Exit Points, then:

(a) each User will be deemed to have made a Disposing Trade Nomination, and Transco NTS will make a corresponding Acquiring Trade Nomination for the User's Emergency Interruption Volume; and

(b) each User hereby authorises Transco NTS to make such Disposing Trade Nominations as are referred to in paragraph (a) on behalf of the User. In the event that, pursuant to paragraph 4.1.1(c), Section D has been suspended, then the Emergency Interruption Volume will be included (in the case of the relevant User) in the calculation of the User's Daily Imbalance for the purposes of paragraph 4.2.2.

6.2.2 Transco NTS will pay to each User an amount determined as the User's Emergency Interruption Volume multiplied by the Emergency Interruption Trade Price.

6.2.3 The amounts payable by Transco NTS pursuant to paragraph 6.2.2 shall be deemed to be Market Balancing Action Charges for the purposes of Section F4.4.3 and Section S.

6.2.4 Transco NTS will not pay Balancing Charges, Balancing Neutrality Charges, Scheduling Charges or Daily Imbalance Charges as a result of transactions occurring as a result of the operation of paragraph 6.2.1.

6.2.5 For the avoidance of doubt, any amounts payable by Transco NTS pursuant to paragraph 6.2.2 shall not be included in the calculation of the System Marginal Buy Price, the System Marginal Sell Price or the System Average Price pursuant to Section F1.2.

6.3 General

6.3.1 The provisions of this paragraph 6 shall apply following Interruption in any Network Gas Supply Emergency (including any Potential Network Gas Supply Emergency) other than a Network Gas Supply Emergency Critical Transportation Constraint Emergency or a Potential Network Gas Supply Emergency Critical Transportation Constraint Emergency."

Subject Matter Expert sign off:

I confirm that I have prepared this modification report in accordance with the Modification Rules.

Signature:

Date :

Signed for and on behalf of Relevant Gas Transporters:

Tim Davis
Chief Executive Joint Office of Gas Transporters

Signature:

Date :