

National Grid NTS Response to UNC Modification Proposal 0067
**“Compensation Payments to Users whose Gas Flows are Curtailed into the System
following instructions received from the NEC”**

Date of Communication: 22/11/2005

External Contact: Ritchard Hewitt (National Grid – NTS)

Slant: None

Strictly Confidential: No

Submitted By: Email Submitted

Abstract

Dear Julian,

Thank you for your invitation seeking representations with respect to the above Modification Proposal. Below is National Grid NTS’s detailed response to the Modification Proposal:

1. The Modification Proposal

The Proposal, noted below, raised a number of points which National Grid NTS considered required clarification by the Proposer prior to National Grid NTS formulating its response and we therefore contacted the Proposer to discuss these points.

From the conversation held with the Proposer it is our understanding that the intent of Urgent Modification Proposal 0067 is limited to seeking to provide appropriate compensation only for Storage Users who have had their flows from storage facilities curtailed by notice from the Network Emergency Coordinator resulting from the breach of Storage Safety Monitors. The Proposal therefore does not seek to provide compensation for other Users utilising other modes of supply.

Furthermore, it is our understanding, from this discussion, that the Proposal intends to replicate the current claims process in full in that payments paid by National Grid NTS to claimants following the outcome of the claims process shall be funded by the Energy Balancing Neutrality Mechanism, as will the fees and costs of the claims reviewer.

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

With respect to the extent to which implementation of the proposed modification would better facilitate the relevant objectives, National Grid NTS considers that the arguments are finely balanced. We believe that further development and clarification of certain points within the Proposal would greatly assist us to formulate a definitive view. With regard to the relevant objectives National Grid NTS would make the following points;

- The Proposal might weaken the incentives on Users to balance their own positions on the Day as under this Proposal the Claimant will have an expectation of a level of compensation to be paid at a later date. This may result in Users opting not to affect their imbalance positions by acquiring gas from other price sensitive supplies such as interconnector gas or LNG importation and might therefore either have a negative impact on security of supply or result in higher cash-out prices as a result of a requirement on the residual system balancer to take a greater volume of trades. The residual gas balancing role may therefore need to expand to cover these instances. We do not

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consider this would further relevant objective A11 (a), the efficient and economic operation of the system or, relevant objective A11 (d), the securing of effective competition.

- National Grid NTS understands from a telephone discussion held with the Proposer that the intent of the Proposal is that any costs resulting from the scheme would be managed via the balancing neutrality mechanism. Those Users with a greater weighting towards storage holdings as a percentage of their annual throughput may, as a result of this balancing neutrality process, obtain commercial benefits, at the expense of those Users with a greater weighting towards beach deliveries as a percentage of their annual throughput, resulting from the smearing of the additional costs via the balancing neutrality mechanism. We do not consider this would further the relevant objective A11 (d), the securing of effective competition.
- If the Proposal is implemented and the proposed arrangements were to be instigated we believe that the cash flows through the Energy Balancing Neutrality Mechanism might approach those identified in the Ofgem document: “The Review of Top Up arrangements in Gas: Conclusions Document”. This document identified potential Top-Up winter injection costs of between £20m (low case, average winter) and £600m (high case, 1 in 50 cold winter) under the existing Top-Up arrangements at that time. National Grid NTS considers that the potential reintroduction of costs of this magnitude smeared through the Balancing Neutrality arrangements would not further the relevant objective A11 (d), the securing of effective competition.
- With respect to the Proposer’s statement that; *“We believe that this modification will improve security of supply by removing any perverse incentive to withdraw gas from storage in the event of an impending breach of a storage monitor or an unforeseen amendment to the storage monitors as permitted under modification 050.”* National Grid NTS does not consider that the existing commercial arrangements provide such an incentive for certain Users to behave in this manner. On the contrary, we believe this incentive, if it exists, should be counter balanced and out weighed by the wider industry benefit of ensuring that sufficient storage stocks are maintained for all Non-Daily Metered consumers including domestic loads, and Priority Loads to meet their demands during a severe Winter period (1 in 50). However, we are cognisant of the fact that this view is widely held by Users and that as such this Proposal may help to alleviate the perception that a perverse incentive exists. We would therefore not rule out the possibility that the introduction of this Proposal might beneficially affect the behaviour of certain Users and might therefore offer some modest benefits to security of supply.
- With regard to the statement put forward by the proposer in the summary of the proposal that *“It is now widely acknowledged that the current storage monitor regime has a number of shortcomings, including discrimination against those shippers booking physical storage capacity (acting reasonably under their licence obligations to cater for their peak supply licence requirement) as compared to shippers not booking a storage service. In the event of an emergency being declared, storage shippers would be unable to access stored gas due to circumstances beyond their reasonable control, namely a declaration of a system emergency by the NEC. This sequestration (of gas stocks in storage during an NGSE) may serve as a disincentive to book storage and may prejudice further storage development which will impact medium and long term security of supply”*. We would like to point out that whilst it echoes the Proposer’s concerns regarding less prudent shippers National Grid NTS considers that the role of the NEC is to deal with the position on the system resulting from the behaviour of all Users in aggregate. The NEC does not have the ability to know which Users are behaving prudently and which are not. National Grid NTS does however understand this concern and would therefore support a full review of the roles and responsibilities for the provision of 1:50 security being undertaken. In terms of the concern expressed by some Users that the value of Storage has been undermined by the

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introduction of Safety Monitors and that this in some way will disincentive long term investment in new Storage facilities, National Grid NTS appreciates that the implementation of this Proposal may alleviate, to some extent, these concerns and may therefore offer some marginal benefits.

3. The implications for Transporters and each Transporter of implementing the Modification Proposal.

i. Implications for operation of the System

It is our belief that this process will operate on an ‘After the Day’ basis and therefore that there will be no impact upon the current operating practices of the System.

ii. Development and capital cost and operating cost implications:

It is our understanding that the Claims Process Costs will be funded via the Neutrality Mechanism. No additional development or capital costs have been identified.

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

The Proposer has stated that; *“We believe that this modification will improve security of supply by removing any perverse incentive to withdraw gas from storage in the event of an impending breach of a storage monitor or an unforeseen amendment to the storage monitors as permitted under modification 050.”*

We do not consider that the existing commercial arrangements provide such an incentive for certain Users to behave in this manner. On the contrary, we believe this incentive, if it exists, should be counter balanced and out weighed by the wider industry benefit of ensuring that sufficient storage stocks are maintained for all Non-Daily Metered consumers including domestic loads, and Priority Loads to meet their demands during a severe Winter period (1 in 50). However, we are cognisant of the fact that this view is widely held by Users and that as such this Proposal may help to alleviate the perception that a perverse incentive exists. We would therefore not rule out the possibility that the introduction of this Proposal might affect the behaviour of certain Users and might therefore offer some modest benefits to security of supply. No impacts on the operation of the Total System or upon industry fragmentation have been identified.

5. The high level affect on the UK Link System and other related Systems for Transporters and Users

We are concerned that there might be an impact on Xoserve processes resulting from the ‘ad hoc’ processing of any claims and their interaction with the energy balancing neutrality process.

6. The implications of implementing the Proposal for Users

In the view of the Proposer, the implications for Users, should this Proposal be implemented, are that a significant disincentive to Users making storage bookings and to storage operators investing in the development of new storage capacity will be removed.

We believe that the major implications of implementing this Proposal would be to (a) lessen the incentives on Users to balance their position on critical Gas Days since they would have the expectation of financial relief via the claims mechanism and, (b) those Users with a greater weighting towards storage holdings as a percentage of their annual throughput may obtain commercial benefits,

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at the expense of those Users with a greater weighting towards beach deliveries as a percentage of their annual throughput, resulting from the smearing of the additional costs via the energy balancing neutrality mechanism.

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

None Identified.

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

Advantages

- Implementation of this Proposal may remove the view held by some Users that the introduction of the Storage Monitors has created a perverse incentive for Users holding gas in store to withdraw that gas from storage in the event of an impending GSMR Safety Monitor Breach potentially hastening the breach and triggering a NGSE. It is therefore possible that the introduction of this Proposal might affect the behaviour of certain Users and may therefore offer some modest benefits to security of supply.
- In the long term, the implementation of this Proposal may alleviate concerns held by some Users that the value of Storage has been undermined by the introduction of Safety Monitors and that this in some way will disincentive long term investment in new Storage facilities.

Disadvantages

- May lessen the incentives on Users to balance their positions since they would have the expectation of financial relief via the claims mechanism.
- May result in significant cashflows, via the energy balancing neutrality mechanism, between different groups of Users i.e. between those who are predominantly reliant on storage supplies and those who are predominantly reliant on beach supplies.
- We believe that a number of areas of this Proposal would benefit from further development or clarification;
 - The Proposal does not explicitly state how compensation payments are to be funded.
 - National Grid NTS’s belief, based on discussions with the Proposer, is that the scheme would be fully funded by the Energy Balancing Neutrality Mechanism.
 - The Proposal does not elaborate upon the basis on which any financial loss would be evaluated.
 - In order to provide some guidance to those submitting claims and to the claims reviewer, National Grid NTS feel that it may be appropriate for Users to further develop this Proposal in this area.

Regards,

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