

## **Pricing Discussion Paper PD15**

### **Options for Reforming the Interruptible Regime**

#### **SUMMARY**

The present interruptible regime can be regarded to some extent as being a legacy of an integrated gas industry, although it also reflects the obligations in Transco's Gas Transporters' Licence. Ofgem has consulted on potential changes to the regime and, as part of its Initial proposals for System Operator incentives, has outlined its vision of how the exit regime should be developed.

Transco has expressed reservations about the Ofgem proposals and has suggested that an evolutionary approach is more appropriate. This discussion paper outlines two broad approaches by which a greater degree of market driven decision making might be introduced into the interruption regime and which are potentially implementable in October 2002.

## 1. Introduction

Within the Network Code, provision is at present made for a standard interruptible service to all supply points with annual consumption above 5,861 MWh (200,000 therms). Under the terms of the Network Code, Shippers can nominate supply points as being interruptible. Transco can interrupt a nominated supply point on up to 45 days annually; in return the relevant Shipper is liable for neither NTS exit nor LDZ capacity charges in respect of the nominated supply point. When interruption is required, Transco chooses between supply points on the basis of an equitability algorithm, although Shippers are free to interrupt alternatives if they so wish.

As well as the standard interruptible service, there are two others which apply to a small number of supply points:

- Network Sensitive Load (NSL) - LDZ supply points where specific interruption may be required to maintain the supply of gas to firm supply points in the same area; and
- Transco Nominated Interruptible (TNI) - supply points where Transco reserves the right to interrupt for more than 45 days each year.

The regime might therefore be characterised as being restrictive in terms of both price and duration, as well as lacking a means of providing Transco with economic signals on which to base decisions. These decisions cover short term issues with regard to which particular supply points should be interrupted on a day to day basis, and long term issues with regard to substitution between pipeline investment, LNG system support or interruptible contracts. While it is appropriate to address these issues, any change must not risk the integrity and security of the gas transportation system. In line with this constraint, Transco believes there is merit in considering two broad approaches to evolving the present interruptible regime. While these approaches seek to develop the existing regime, it will be necessary to consider whether they are consistent with existing Licence obligations regarding cost-reflectivity.

## 2. Variable Duration Regime

Under this approach, Transco would offer a range of interruptible contracts, each with a different level of capacity charge adjustment for a given maximum period of interruption. Shippers would choose the transportation arrangement they wished to adopt in respect of each interruptible supply point. A linear relationship, such as set out below, may suffice in terms of specifying the relationship between contract duration and capacity charge avoided. However, more complex relationships could also be accommodated.

- 45 day service with 100% of maximum transportation charge adjustment.
- 35 day service with 75% of maximum transportation charge adjustment.
- 25 day service with 50% of maximum transportation charge adjustment.
- 15 day service with 25% of maximum transportation charge adjustment.

With this approach, there would be a need to define rules which established a hierarchy in the probability of interruption in circumstances where Transco faced a choice about which loads should be interrupted to relieve a potential constraint. For example, supply points nominated by Shippers as having 45 day services could be interrupted in the first instance until all had been interrupted for ten days, at which point supply points nominated as having 35 day services would also become liable for interruption, and so on.

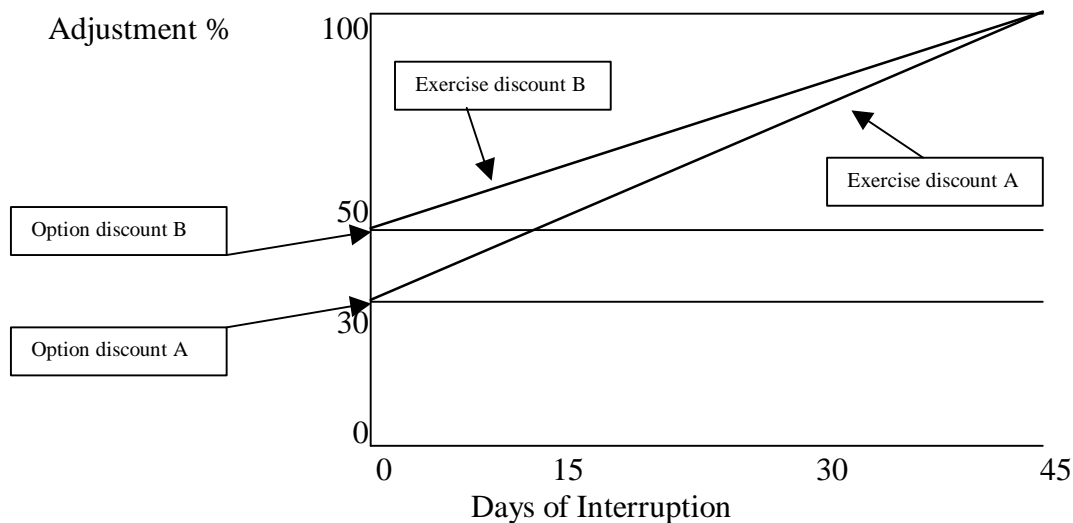
This scheme may be attractive in its simplicity and similarity to present arrangements, but there are major potential issues surrounding the security of Transco’s system, at least in the short term, should the regime lead to a very different interruption capability – in terms of both space and deliverability - than is presently available. The rigidity of the approach and the limited number of options available may also be regarded as possible weaknesses.

### 3. Option and Exercise Regime

Under this approach, separate option and exercise capacity charge adjustments would be created. The level of the option adjustment would be independent of the duration of interruption, but the level of the exercise adjustment would depend on the number of days on which interruption occurred. To introduce such an approach, it is envisaged that Shippers could nominate a level of option adjustment for each supply point, while the exercise adjustment would be calculated using the following formula:

$$\frac{100 - \text{option } \%}{45}$$

Thus the total potential level of charge adjustment would be the same for all supply points but Shippers would choose their preferred split between the two mechanisms. The diagram below demonstrates how such a regime might operate. On any day that Transco required interruption and a choice of sites was available, it would interrupt B before A because the marginal cost of doing so would be lower.



The level of possible option fees could be limited to a number of discrete levels, or could be entirely flexible within upper and lower boundaries. In either case a hierarchy of supply points with different marginal costs of interruption would be created, on which Transco could base its interruption decisions.

All interruptibles would remain of 45 days duration thus removing the prospect of a radical change in the capability of interruption available to Transco. A further variation, however, would be a regime under which 100% of the available adjustment was achieved at a level of interruption below 45 days, with the adjustment increasing beyond that at the exercise adjustment rate.

Although the regime offers a wide range of possible option and exercise adjustments it may take time to fully develop and in the short term bunching around a particular level of option adjustment could militate against the creation of an effective hierarchy. However given that this would have resulted from freely made choices by Shippers, this may not be regarded as a significant problem.

#### **4. Treatment of NSLs and TNIs**

At present transportation to TNI supply points not only avoids NTS exit and LDZ capacity charges but also attracts reduced NTS and LDZ commodity charges. This reduction is linked to the number of days above 45 on which interruption can be called by Transco. At present, there is no additional reduction in transportation charges to NSL supply points relative to the charges to equivalent standard interruptible supply points.

There is a number of means by which these categories of interruptible could be incorporated within the regimes outlined.

Under the Variable Duration Regime, TNIs could be accommodated naturally within the structure, so that, for example under the structure outlined, a 55-day TNI service could receive 125% of the normal maximum transportation charge adjustment. NSLs might be restricted, at least in the short term, to being on the 45-day service and so would get 100% of the normal adjustment. However, it might be appropriate for transportation to NSLs to get a higher level of adjustment than to standard interruptible supply points with the same maximum duration, for example 110% of the normal maximum adjustment for a 45-day maximum NSL service.

Under the Option and Exercise Regime, TNIs could be handled by allowing exercise beyond the normal 45 day maximum but still determining the exercise adjustment in the standard manner. In this case, if the TNI were interrupted beyond 45 days it would get a greater level of transportation charge reduction. NSLs would also be accommodated in the standard manner with this regime. Since NSLs on average may experience more days of interruption than standard supply points in typical years, transportation to them would automatically attract a greater level of charge reduction than to standard supply points with the same option-exercise split but which were interrupted on fewer days.

## **5. Implementation Issues**

The introduction of any new interruptible regime is likely to require changes to the Network Code. Areas where amendment will be required are:

- Possible application of ratchet and over run rules to interruptible supply points;
- Supply point registration;
- Amendment of bottom stop and capping rules with regard to SOQ; and
- Possible alteration of interruption procedures and failure to interrupt charges.

Changes to the present regime are also likely to require significant IT developments for both Transco and Shippers. For example, Transco would need to update those billing and network management systems that relate to interruptible supply points.

A combination of the need for Network Code modification and IT development lead times mean that it is highly unlikely that any new mechanism could be introduced before October 2002.

## **6. Conclusion**

Ofgem's initial proposals for System Operator incentives outline an interruptible regime which Ofgem would wish to see introduced. Transco has argued that it would be impractical to adopt such an approach in a short timescale, and that an evolutionary approach to regime development would be appropriate. In this respect Transco believes that there may be merit in developing its Transportation Charging Methodology in respect of interruptible supply points such that customers are able to provide Transco with economic signals on which to base decisions related to the interruption regime. However, Transco believes it is essential that any such mechanism should not lead to a reduction in the present levels of system security.

Transco would welcome views from the community on whether and how transportation charges relating to interruptible supply points should vary from present arrangements such that they might facilitate more commercial decision making by Transco. In particular views would be welcome on the relative merits of the two potential options set out in this discussion paper.

Transco would also find it helpful to receive views from all parties on alternative approaches, such as that set out in Ofgem's SO Incentives Initial Proposals.