

Further details of BG's proposal for a market in peak gas

Contract features for the market in peak gas

1. BG envisaged at least three types of contract for the purchase of peak gas by those who needed it. The first would probably be a bilateral negotiation for long-term peak supplies from offshore gas producers (similar to BG's existing Sean contract). The second concerned the provision of peak from one shipper to another via the interruption of customers. These could be either long-term contracts or much shorter-term arrangements, under relatively standard terms. Finally, there were other sources of peak supplies (eg power generators). These contract types might well have some common features, and BG's initial ideas are set out below. BG was seeking views on these peak trading contract features.

Contract period

2. A range of contract periods could apply up to 10 to 15 years. Given the importance of peak supplies in ensuring chosen levels of security of gas supplies to firm customers (particularly where the buyer had statutory obligations to supply) and the lead times associated with some alternative sources of peak supply (beach swing and storage), it could be expected that some buyers of peak supplies would wish to contract for a large proportion of peak on a medium- to longer-term contract.

3. BG said that, initially at least, a buyer of peak would probably not want to plan to rely on a short-term or 'spot' market for such an important source of supply. These contract features were not intended to cover peak trading in such a 'spot' market. However, where peak sales were based on interruption by the seller of peak to release beach supplies, it might be difficult for sellers of peak to commit to longer-term peak contracts, given the highly price-sensitive nature of most of the interruptible sales market. It had to be recognized, however, that having entered the interruptible market and made contractual arrangements to purchase the gas to support the sale, the peak gas would probably be available irrespective of the price of HFO.

Quantities

4. The two most important elements to be covered here would be:

- (a) a maximum daily quantity which the buyer of peak could ask to be delivered on any day and the seller would be obliged to provide; and
- (b) a duration period, being the period during each contract year when the buyer could nominate and the seller would be obliged to deliver.

A further two features could be:

- (c) a maximum annual quantity, being a total volume which the buyer could take and the seller would be obliged to provide over a year. This feature was probably most appropriate to peak supplied through interruption; and
- (d) a maximum contract quantity which the buyer of peak could ask to be delivered over the contract period.

For shorter-term contracts, quantities could be fixed for the term of the contract. For longer-term peak contracts, there could be procedures for these quantities to be varied over time (within limits) by either the buyer or the seller on (fairly long) notice periods.

5. In setting the maximum daily and any annual volumes, the buyer would take into account quantities available from other sources of peak (beach, swing, storage) and their durations. The seller would want to take

into account its own needs for peak supplies to serve its firm demand, and its own alternative sources of peak. The seller would also have the complementary terms in its own interruptible contracts, both for the provision of gas and for transportation.

Point of supply

6. Generally, BG envisaged that sale and purchase of peak supplies would take place at beach delivery points (terminals). This would be the point at which title and risk would pass from seller to buyer and performance of obligations under the contract would be measured.

7. For shorter-term peak trading, a fixed point of supply (terminal) could be agreed between seller and buyer. However, for longer-term peak sales through interruption of customers, it might be that the buyer would be unable to agree a point of supply for the term of the contract, given that the beach supply sources for the peak supply might change over time. In these circumstances, seller and buyer could agree procedures for notification of the points of supply in advance of each contract year.

8. In addition, more than one point of supply could be agreed and this would need to be reflected in the quantities provisions of the contract—specifically the maximum daily quantity applying at each point of supply.

Price

9. The following structure of pricing arrangements might be considered suitable for sale and purchase of peak supplies:

(a) *A capacity charge.* Given that the seller of a peak supply would be 'standing ready' to provide peak on demand by the buyer, the seller could not plan to use this source of gas to supply firm sales markets. This would mean that a seller of peak could incur an opportunity cost and this would be a cost incurred whether the buyer actually called on a peak supply or not. Therefore, it could be envisaged that an annual capacity charge for each therm of the maximum daily quantity could be payable by the buyer to the seller in regular instalments during each year of the contract, whether any gas was supplied or not. For short-term contracts, it might be that the capacity charge could be fixed for the term of the contract. For medium-term and longer-term contracts, provisions would probably be needed for indexation of the initial capacity charge to appropriate indices, at agreed intervals during the contract. As the sale and purchase of peak would be taking place 'at the beach', buyer and seller would have to agree responsibility for booking and paying for transportation entry capacity with BG T&S.

(b) *A commodity charge.* In addition to a capacity charge, which would be payable whether gas was supplied or not, a commodity charge would be payable for each therm of gas actually supplied. As with the capacity charge, for short-term contracts the commodity charge could be final for the term of the contract. But for medium-term or longer-term contracts, buyer and seller would almost certainly want to agree provisions for indexation of the initial commodity charge to appropriate indices at agreed intervals during the contract.

Delivery procedures

10. The contract would need to cover the daily nomination procedures and, in particular, the notice required for nominations. Given the importance of peak supplies to the buyer in meeting firm demand at a certain level of security of supply and the speed at which firm demand might increase, these were important provisions of the contract. In addition, the contract would probably cover the giving of regular (non-binding) estimates by the buyer for the requirements of peak supply gas.

11. An important aspect of nomination procedures in respect of peak gas supplied through interruption was the relationship with BG's own proposals for balancing, as set out in the joint consultation document on gas transportation and storage. A key point for consideration was whether shippers undertook the contractual act of

interrupting their own customers, in which case they would need the resources to do this, or whether they contracted with an agent (possibly BG T&S) to undertake this for them. The interruptible sales contract would need to reflect such a transfer.

Performance

12. Given the importance of peak supplies to the buyer and the consequences of unavailability of peak supplies, the contract will need firm remedies to be available when performance under the contract was not in accordance with obligations. One way of achieving this could be to have a payment according to performance arrangement, whereby capacity charges and, possibly, commodity charges actually paid by the buyer varied with the extent to which the seller had met nominations for peak supply by the buyer.

Quality, pressure and measurement of gas supplied

13. Gas supplied under the peak contract would need to be at such quality and pressure as would conform to the quality and pressure requirements for transportation in the NTS. However, given that, for peak supplied via interruption, the seller's source of peak gas would need to comply with these standards when being used by the seller as a source of own supply, this should present no difficulty.

14. The contract would need to set out procedures for the measurement of gas supplied. There would also need to be allocation arrangements where the peak supply was delivered commingled with other suppliers' gas.

Other provisions

15. Other, more standard, provisions of the contract would involve termination rights, confidentiality, billing and payment terms, assignment, warranties and indemnities etc.

System operations issues

Interruption arrangements

16. It was expected that the majority of interruption under peak trading arrangements would be planned on the previous day (day D-1) but that some interruption would be necessary within-day (day D). The implementation of effective information flows between gas marketers and BG T&S would be vital to the introduction of peak trading.

Interruption on day D-1

17. Currently, the majority of interruption was arranged by 1800 hours on day D-1, the time at which beach nominations were made, for commencement at 0600 hours on day D. Under the proposed structure, it was expected that interruption arranged on day D-1 would be carried out by gas marketers, based on their own supply and demand considerations for the following day, including any contracts in place with other marketers for transfer of peak gas.

Interruption on day D

18. The day D-1 arrangements should operate effectively, in the absence of forecasting errors or supply problems. In practice, forecasting errors or supply problems occurred on nearly all days and the demand for gas could rise sharply over a short period. At low demand levels, this would be remedied through the anticipated beach renomination arrangements, but at high demand levels, when storage gas could be used, action to interrupt needed to be taken quickly to bring supply and demand back into balance, if the additional use of storage was to be avoided.

19. Within-day interruption had a similar effect to upward renominations and the transportation and storage system had been designed to take full advantage of the flexibility offered. Under the proposed structure, BG T&S could gain access to this flexibility by putting in place arrangements similar to the renomination arrangements. This could be a parallel but separate scheme from renominations, or could be incorporated into one of the proposed renomination schemes described in the joint consultation document. BG noted that such an arrangement was distinct from any right of interruption that BG T&S might have due to transportation capacity constraints under interruptible transportation contracts.

Information flows

20. Accurate and reliable information flows regarding gas inputs and gas offtakes were essential for safe and efficient operation of the pipeline network. The information ensured that BG T&S demand forecasting was on a sound basis and that the effect of interruption on the supply and demand balance for the system as a whole could be correctly predicted and storage use minimized.

21. The nomination procedures for gas marketers' beach deliveries, as set out in the joint consultation document, would ensure that BG T&S had proper knowledge of intended input rates by sub-terminal. On day D-1 such nomination procedures would need to include the effect of any peak trading. Likewise, demand information in respect of interruptible load was also an essential requirement for system operations. In particular, BG T&S would need to be advised of the timing, location and magnitude of any such interruption, in order to plan the operation of the network in an efficient and secure manner.

22. Periods of high activity with respect to information flows would be in the afternoons and evenings in winter periods when nomination and interruption arrangements were being made for the day ahead.

23. Where peak trading occurred on day D, appropriate information relating to beach input changes and interruption of demand would need to be provided to BG T&S by gas marketers in a timely fashion, to enable BG T&S to maintain the daily balance of supply and demand.

24. Interruption on day D could obviously occur at any time and 24-hour control capability would be necessary to implement these procedures. The intention to interrupt should be notified by gas marketers to BG T&S operationally, with as much notice as possible, and individual sites must be specified in order that BG T&S could manage its system and, in particular, the use of storage gas. It should be possible for gas marketers to appoint an agent (another marketer or perhaps BG T&S) if they did not wish to establish round-the-clock contact procedures.

Network Code

25. The information flows regarding gas inputs and gas offtakes would be a very important part of operational balancing. In addition, to operate the accounting procedures set out in the joint consultation document, BG T&S needed to be informed of the quantities delivered by each gas marketer at each sub-terminal, shortly after the end of the day. This would include any quantities of gas delivered under peak trading arrangements.

26. Under the Network Code arrangements set out in the joint consultation document, gas marketers needed to arrange supplies on day D-1 to meet BG's core nomination and the gas marketer's forecast of non-core offtakes. At times of high demand, these supplies might be arranged via peak trading involving interruption planned on day D-1. In this case, the instruction to customers to interrupt take of gas would be carried out by gas marketers.

27. Where a supply shortfall arose on day D, BG T&S would call for more gas under the renomination arrangements (or any parallel scheme for interruption) and gas marketers would respond, interrupting customers as appropriate.

28. The Network Code would need to deal with the exchange of information necessary for system planning. Clearly the security of supply provided to the core market would be dependent on the storage facilities available,

beach gas availability and peak trading arrangements. Immediately prior to each winter BG T&S would be expected to make an assessment of the supply security based on the then current situation. To the extent that the peak market was uncertain, this would have an impact on the supply security year by year.

29. BG said that the core/non-core proposals in the joint consultation document would allow gas marketers to select the security of supply for customers in the non-core market, whilst preserving the common level of security for core customers. To the extent that gas marketers of non-core load did offer lower than standard levels of security, the peak trading proposals offered such marketers an opportunity to trade in the peak gas thus released. The non-core market proposed by BG comprised about 9,000 customers (rather than the 1,500 current BG interruptible sales customers) and this was considered to be a manageable number of non-core customers, given the requirement to monitor the booked transportation and storage services provided to the sites, and the necessity to take action if these were exceeded.

30. Whenever interruption took place, additional gas would be made available at the beach terminals for exchange between gas marketers and then for transportation through the BG T&S system to different customers. The transportation of peak gas would have to be consistent with the transportation capacity booked by individual gas marketers, and arrangements would, therefore, need to be made in the transportation and storage contracts to deal with this.