

URGENT Modification Report
Changes to Capacity Neutrality to enable Implementation of Final SO Incentive
Proposals
Modification Reference Number 0539
Version 1.0

This Modification Report is made pursuant to Rule 9 of the Modification Rules and follows the format required under Rule 8.9.3.

Circumstances Making this Modification Proposal Urgent:

In accordance with Rule 9.1.2 Ofgem has agreed that this Modification Proposal should be treated as Urgent because Transco anticipates revised SO incentives being implemented via revisions to its GT Licence with effect from 1 April 2002. However, these licence amendments will not be finalised before 1 April 2002. Once finalised, it is anticipated that the Licence amendments will be applied retrospectively and take effect from 1 April 2002. Urgent status was therefore sought for this proposal to ensure that new arrangements can put into effect from 1 April 2002 through transitional arrangements in the Network Code. Ofgem has agreed that this Proposal be given urgent status to provide Transco and shippers with greater certainty about the transitional arrangements for Transco's obligations with regards to the treatment of revenues generated from Overruns and Daily System Entry Capacity (DSEC) acquired at the day ahead stage.

Procedures Followed:

Transco agreed with Ofgem (and has followed) the following procedures for this Proposal:

<i>Issued to Ofgem for decision on urgency</i>	<i>5 March 2002</i>
<i>Proposal agreed as urgent</i>	<i>7 March 2002</i>
<i>Proposal issued for consultation</i>	<i>7 March 2002</i>
<i>Close out for representations</i>	<i>20 March 2002</i>
<i>Final report to Ofgem</i>	<i>22 March 2002</i>
<i>Ofgem decision expected</i>	<i>28 March 2002</i>

1. The Modification Proposal

At present both day ahead and within day sales of Daily System Entry Capacity (DSEC) count toward capacity neutrality, while Overrun Charges count toward Transportation Revenue. The purpose of this proposal is to amend the existing Network Code rules for the treatment of revenue associated with Overrun charges and sales of DSEC before the gas flow day. It is proposed that revenues from Overrun Charges should be counted in Transco's buy back incentive and consequently it should be included in capacity neutrality calculations. Revenues from Overrun Charges would be included in neutrality. In addition it is proposed to amend the Network Code such that any revenues generated from DSEC acquired at the day ahead stage would be excluded from capacity neutrality.

To enable DSEC acquired by the day ahead stage to count towards TO Allowed Revenue the proposal envisaged that a new Charge Type may be required, which in

turn would require a change to the file formats. The three month fifteen day notification period required by the UK Link committee for file format changes may therefore need to be waived to allow this Modification Proposal to be implemented.

2. Transco's Opinion

Transco supports this Modification Proposal as it believes implementation is required to facilitate implementation of Ofgem's final proposals in respect of Transco's NTS System Operator incentive schemes. Implementation would enable Transco to fulfil its anticipated obligation to include revenues from Overrun Charges in Transco's buy back incentive and consequently in capacity neutrality calculations. In addition any revenues from DSEC acquired at the day ahead stage would be excluded from capacity neutrality.

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

This proposal was raised in anticipation of changes to be proposed by Ofgem through Licence amendments. These changes would facilitate compliance with the relevant objective contained within Standard Condition 9(1)(b), i.e. the efficient discharge, by Transco, of obligations under its GT Licence.

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

a) implications for the operation of the System:

There are no such implications

b) development and capital cost and operating cost implications:

There are no such costs

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

Any additional System Operator costs incurred as a result of implementing this Proposal would be accounted for under the proposed internal cost incentive scheme, as set out in Ofgem's final proposals for the System Operator incentives.

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

There are no such implications

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

Transco does not believe there are any such consequences

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

Within the Modification Proposal Transco recognised that file format changes may be required. Transco now believes that no file format changes are required although additional Revenue Share flags are required to accommodate the revised revenue calculations.

7. The implications of implementing the Modification Proposal for Users

If this proposal is implemented it will provide certainty for Users concerning the arrangements for the revenue generated from Overrun charges and revenues generated from DSEC acquired at the day ahead stage in the absence of Transco's revised GT Licence which is expected to be implemented with effect from 1st April 2002.

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

There are no implications

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

The anticipated licence amendments alluded to in this Modification Report are based on Transco's understanding of Ofgem's final proposals for Transco's SO incentives. The proposed licence amendments are to be the subject of a consultation under section 23 of the Gas Act 1986 and no assumptions can be made regarding the outcome of that process.

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

Advantages :

- It will ensure that Transco complies with anticipated amendments to its GT Licence.

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

Transco received a total of 9 representations for this Proposal:-

Agip(UK) Ltd (AGI)
British Gas Trading Ltd (BGT)
Innogy (INN)
Powergen UK plc (POW)
TotalFinaElf gas and Power Limited (TFE)
Scottish and Southern Energy Plc (SSE)
Norsk Hydro (UK) Ltd (NHL)

Shell Gas Direct (SGD)
London Electric (LE)

Five respondents supported the Proposal in the current form

One respondent did not express a view on the Proposal.

Three respondents did not support the Proposal

Delay to Licence

Eight of the respondents (BGT, INN, POW, TFE, SSE, NHL, LE and SGD) stated that, due to the delay in the publication of the proposed GT Licence amendments, comments are based on a Proposal that is based on Transco's interpretation of the revised GT Licence prior to publication of the Licence. BGT and SSE reluctantly support the Transco Proposal as a pragmatic way forward. Several other respondents agreed that the Proposal is taking a realistic approach. NHL had concerns about commenting on the Proposal "...without first having sight of the detailed licence conditions....". TFE stated "Until the Licence Proposals are published, let alone finalised we are unwilling, and in truth, unable to comment meaning fully on this proposal...". SGD expressed concern that "...Shippers have not yet had sight of the proposed licence changes, it is very difficult to ascertain what change is anticipated to be implemented through this modification.". Based on their concerns on the Licence process SGD "... recommend considering an approach whereby the current price control is "rolled forward" with introduction of the new control aimed for October 2002 ...".

TFE also "... find it unacceptable that by raising this proposal Transco is seeking to introduce contractual changes, which contain significant commercial implications to shippers, whilst effectively hedging its own commitment to these changes."

Transco Response

Transco sympathises with Users' views concerning the delay in publication of proposed amendments to Transco's GT Licence. Transco believes, however that Ofgem has indicated in published documents that the revenues from Overrun charges and DSEC acquired at the day ahead stage should be dealt with in a manner consistent with this Modification Proposal. Ofgem has indicated that the GT Licence will be implemented with effect from 1 April 2002. By raising this Proposal Transco is proposing to behave in line with this obligation even if it is not contained within the Licence on 1 April 2002.

Transco welcomes the view that it is taking a pragmatic approach to an area where Users have significant concerns.

Timescales

Four shippers (BGT, SSE, LE and INN) expressed concern about the timescales involved in implementing this proposal and the operational impact that this has on Users. BGT registered its "...concern that these interim measures add greater uncertainty to every Users operation.". SSE "... do not believe that this approach is consistent with the objectives of promoting sustainable competition in gas shipping and supply, nor does it provide stability in transportation charges, which ultimately influence the prices paid by customers."

Transco Response

Transco understands the concerns that have been raised by respondents about the timescales and the impact on Users operations. However as Ofgem has indicated that it expected GT Licence amendments to be implemented with effect from 1 April Transco need to ensure that the regime that is being operated, by both Users and Transco, reflects the changes indicated by Ofgem in published documents.

Network Code / Licence Relationship

Both POW and AGI supported the Proposal but expressed the view that the revised arrangements should remain part of the Network Code on a permanent basis and not form part of the Licence. POW are concerned that "... it will be impossible for shippers to make changes ..." to the incentive schemes.

INN is unclear as to "...how this suite of modifications fits with Modification proposals 0519 and 0520...". SSE noted that "... there will be a need to remove the incentive from the Network Code...." and "... that this could be facilitated via further consultation on modification 520 (Removal of entry capacity incentives from the Network Code), (currently with Ofgem for a decision), in accordance with Modification Rule 8.10.1(b) as the circumstances relating to it would have materially changed." Three shippers (INN, SSE and SGD) felt that until the Licence changes are finalised and agreed, a reconciliation process maybe required even if this Proposal is implemented.

Transco Response

The treatment of revenues from Overrun charges and revenues generated from DSEC acquired at the day ahead stage detailed within this Proposal would be contained within the Network Code on a permanent basis. Transco believes that Ofgem has indicated in published documents that the revenues from Overrun charges and DSEC acquired at the day ahead stage should be dealt with in a manner consistent with this Modification Proposal. Based on this indication Transco believes that this Proposal will ensure that no reconciliation process will be necessary when GT Licence amendments are implemented.

The nature of Modification Proposal 0520 is to migrate the existing transitional Entry Capacity neutrality provisions into the substantive body of the Network Code and to remove the Entry Capacity incentive scheme provisions from the Network Code. The Entry Capacity incentive scheme would instead be defined within Transco's GT Licence.

Daily Sales Revenue

INN and SSE raised concerns that under the TO price control any unsold baseline would form part of TO revenue and requested further clarification on this point. SGD understood "... that all daily sales of firm capacity would be treated as part of the buy back incentive ...", but again wished for further clarification and consultation on this point. SSE "... agreed that there is a need to change the Network Code rules in respect of the treatment of revenue from overrun charges and sales of Daily System Entry Capacity (DSEC) before the day...." But "... believed that further debate on the appropriate methodology for calculating overrun charges should be initiated....".

SSE also requested clarity as to whether exit overruns remain part of TO revenue.

LE "... do not agree that the revenue from Overrun Charges should count towards Transco's buy-back incentive..." but are in agreement with regards to the revenues from DSEC counting towards Transco's TO Allowed Revenue.

Transco Response

Any revenue derived in respect of baseline entry capacity acquired at the day ahead through DSEC auctions will count towards TO Allowed Revenue and be excluded from capacity neutrality. If any subsequent entry capacity is sold at the within day stage (via DSEC) the revenues generated will count towards Transco's buy back incentive and consequently will be included in capacity neutrality. Transco believes that Ofgem has indicated in published documents that the revenues from Overrun charges and DSEC acquired at the day ahead stage should be dealt with in a manner consistent with this Modification Proposal.

Exit overruns are not included in the current Proposal.

File Formats

Three shippers (INN, LE and SGD) requested further clarity on the timescales and implications of the file format changes. Both SSE and INN expressed a view that generally the file format period should stay the same.

Transco Response:

Transco believes that no file format changes are required, although additional Revenue Share flags are required to accommodate the revised revenue calculations.

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

Implementation is not required to facilitate compliance with any such legislation.

13. The extent to which the implementation is required having regard to any proposed change in the methodology established under Standard

Condition 4(5) or the statement furnished by Transco under Standard Condition 4(1) of the Licence

Implementation is not required having regard to any proposed change in the methodology established under Standard Condition 4(5) of the statement furnished by Transco under Standard Condition 4(1) of the Licence.

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

There are no such works required.

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

Final Modification Report issued	22nd March 2002
Ofgem decision expected	28th March 2002
Implementation	1st April 2002

Following further discussions with Ofgem, it is Transco's belief that Ofgem intend to make a decision on this Proposal on or before 27th March 2002

16. Recommendation concerning the implementation of the Modification Proposal

Transco recommends that this proposal be implemented.

17. Restrictive Trade Practices Act

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

18. Transco's Proposal

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

19. Text

TRANSITION DOCUMENT, PART II

Add new paragraph 8.1.12 to read as follows:

"B2.13 With effect from 1st April 2002 and without prejudice to the continued application of paragraph 8.1.11 of this Part II in respect of preceding calendar months, Section B2.13 shall continue not to apply and the arrangements set out in paragraphs (2) to (6) (inclusive) and (17) of paragraph 8.1.11 shall apply in respect of each calendar month such that the difference between amounts received or receivable and paid or payable by Transco in a calendar month in respect of Relevant Capacity Revenues and Relevant Capacity Costs shall be payable or recoverable from relevant Users (as defined in paragraph 8.1.11) (and such amount shall not be reduced by any amount to be retained or borne by Transco), provided that for each Aggregate System Entry Point and in respect of a calendar month:

- (1) without prejudice to paragraph (3), Relevant Capacity Revenues:
 - (a) shall not, save where provided in paragraph 8.1.3B below, include Capacity Charges payable to Transco in respect of Daily System Entry Capacity (for a Day in the relevant calendar month) where the User was first registered as holding the Daily System Entry Capacity pursuant to a capacity allocation on the Preceding Day; and
 - (b) shall include System Entry Overrun Charges payable by Users in respect of a Day in the relevant calendar month;
- (2) Capacity Neutrality Charges shall not include User Monthly Capacity Incentive Amounts;
- (3) when calculating the Capacity Revenue Neutrality Charge Relevant Capacity Revenues shall be deemed to be reduced by the amount of System Entry Overrun Charges payable by Users in respect of a Day in the calendar month; and
- (4) when calculating the Capacity Cost Neutrality Charge, Relevant Capacity Costs shall be deemed to include System Entry Overrun Charges payable by Users in respect of a Day in the calendar month."

Signed for and on behalf of Transco.

Signature:

Tim Davis
Head of Regulation NT&T

Date:

Gas and Electricity Markets Authority Response:

In accordance with Condition 9 of the Standard Conditions of the Gas Transporters' Licences dated 21st February 1996 I hereby direct Transco that the above proposal (as contained in Modification Report Reference **0539**, version **1.0** dated **25/03/2002**) be made as a modification to the Network Code.

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

Signature:

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

Signature:

Process Manager - Network Code
Transco

Date:

Annex

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