

**Draft Modification Report**  
**Removal of Entry Capacity Incentives from the Network Code**  
**Modification Reference Number 0520**

Version 4.0

This Draft Modification Report is made pursuant to Rule 7.3 of the Modification Rules and follows the format required under Rule 8.9.3.

## **1. The Modification Proposal**

Following the implementation of Modification Proposal 0488 'Redesign of Capacity Incentive Regime' entry capacity costs are handled via a neutrality process that operates independently of Transco's entry capacity incentive scheme. The Network Code provisions that give effect to the current entry capacity neutrality process and incentive scheme are transitional arrangements only. These transitional arrangements will expire on 31 March 2002.

The nature of this Modification Proposal 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 Gas Transporters (GT) Licence.

The purpose of this Modification Proposal is to decouple the calculation and management of entry capacity incentive amounts from the entry capacity neutrality process. The Network Code provisions which relate to and underpin the neutrality process through which entry capacity costs are managed would be unaffected by this Modification Proposal.

It would be necessary to coordinate the implementation of this Modification Proposal with any relevant amendments to Transco's GT Licence to help to ensure that no conflict arises between the provisions of the Network Code and Transco's GT Licence.

## **2. Transco's Opinion**

Transco believes that this Modification Proposal is required to facilitate Ofgem's proposals to revise the structure of Transco's NTS System Operator (SO) incentives. Ofgem's proposals would result in the definition of Transco's incentives, incentive parameters and provisions for the calculation of incentive amounts being contained within Transco's GT Licence.

Transco believes this Modification Proposal would facilitate Ofgem's proposals by enabling the migration of Transco's entry capacity incentive scheme from the Network Code into Transco's GT Licence. This migration would result in the NTS SO entry capacity incentive being defined through Transco's GT Licence.

Transco believes that failure to implement this Modification Proposal might lead to inconsistency, duplication and conflict between the provisions of the Network Code and the potential Transco GT Licence conditions.

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

In the event that Transco's entry capacity incentives are incorporated into Transco's GT Licence, Transco believes that it would be necessary to remove the existing provisions that relate to entry capacity incentives from the Network Code to mitigate the risk of a conflict arising between the terms of the Network Code and Transco's GT Licence.

Therefore, Transco believes that implementation of this Modification Proposal would better facilitate adherence to the relevant objective contained in Standard Condition 9 of its GT Licence, i.e. the efficient discharge of Transco's obligations under its GT Licence.

**4. The implications for Transco of implementing the Modification Proposal , including  
a) implications for the operation of the System:**

If this Modification Proposal is implemented there would not be any implications for the operation of Transco's System.

**b) development and capital cost and operating cost implications:**

Transco is not aware of any development, capital or operating cost implications that would arise from the implementation of this Modification Proposal.

**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:**

Not applicable.

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

This Modification Proposal does not propose any changes to Transco's allowed revenue or the way in which it is recovered.

**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**

The effect of this Modification Proposal would be to marginally reduce Transco's contractual risk under the Network Code through the removal of the entry capacity Incentive scheme. However, it is envisaged that this affect would be offset by the inclusion of Transco's entry capacity Incentive scheme in Transco's GT Licence.

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

Transco's computer systems would be unaffected if this Modification Proposal is implemented. Transco is unaware of any impact upon Users' systems.

**7. The implications of implementing the Modification Proposal for Users**

If this Modification Proposal is implemented Users would no longer receive ad-hoc invoices in respect of entry capacity incentive amounts.

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

Transco is unaware of any such 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 contractual obligations faced by Transco and Users in relation to Transco's entry capacity Incentive would cease to be defined by the Network Code.

The regulatory obligations which would arise from the potential amendments to Transco's GT Licence are not the subject of this Modification Proposal.

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

The advantages of implementing this Modification Proposal are:

- facilitating the implementation of Ofgem's proposed governance structure;
- prevention of a potential conflict of terms between the Network Code and Transco's GT Licence in respect of Transco's NTS SO incentive schemes;
- facilitation of an appropriate governance structure and a stable regulatory regime within which Transco may respond to its incentives.

The stated advantages are consistent with Ofgem's view that "...those aspects of the new incentive arrangements that have the potential to materially affect Transco's financial position should be included in its licence. We consider that this is necessary to provide Transco with a sufficient degree of certainty in order to allow it to respond to its incentives." (paragraph 11.6: Transco's NTS SO incentives 2002-07, Final Proposals).

The disadvantage of this Modification Proposal is that the Network Code may be considered to be more flexible than Transco's GT Licence in respect of the ease with which it may be amended to respond to regime changes. However, Ofgem has adopted the view

that this disadvantage is offset by the need to balance "...the flexibility offered by the Code against the need for stability and certainty." in determining the appropriate governance structure for Transco's incentives. (paragraph 11.5: Transco's NTS SO incentives 2002-7, Final Proposals).

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

Representations are now sought in respect of this Modification Proposal.

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

Not Applicable.

**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 of this Modification Proposal is not required in relation to any proposed change in the methodology established under Standard Condition 4(5) of the statement.

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

A program of works would not be required as a consequence of implementing this Modification Proposal.

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

It is proposed that the implementation of this Modification Proposal be aligned with the potential modifications to Transco's GT Licence and be implemented no earlier than 1 April 2002.

**16. Recommendation concerning the implementation of the Modification Proposal**

Transco recommends implementation of this Modification Proposal is aligned with, and subject to, modification of Transco's GT Licence.

**17. Text**

**SECTION B: SYSTEM USE AND CAPACITY**

Amend paragraph 1.7.3. to read as follows:

- 1.7.3. “..... Determined by reference to the quantity of the gas flow (or the part thereof attributable to a User) at a System Point, or a charge payable by reference to incentive arrangements contained in the Transco Licence.

*Delete all text at paragraph 2.13, rename as 'Capacity neutrality arrangements' and insert new text to read as follows:*

2.13.1 For each Aggregate System Entry Point the difference between amounts received or receivable and paid or payable by Transco in respect of Relevant Capacity Charges and certain other amounts in each calendar month shall be payable to or recoverable from relevant Users (and such amount shall not be reduced by any amount to be retained or borne by Transco).

2.13.2 For each Aggregate System Entry Point, in relation to each calendar month:

(a) **"Relevant Capacity Revenues"** are the aggregate of the amounts payable to Transco by Users:

(i) by way of Capacity Charges in respect of Daily System Entry Capacity and Daily Interruptible System Entry Capacity at the Aggregate System Entry Point; and

(ii) where any User has negative Available System Entry Capacity, by way of System Entry Overrun Charges pursuant to (and calculated in respect of the amount determined under) Section B5.5.2(ii),

in respect of Days in the calendar month;

(b) **"Relevant Capacity Costs"** are the aggregate of the amounts payable by Transco to Users by way of Capacity Surrender Charges and Aggregate Constraint Amounts pursuant to Section I3.7.2, in relation to the Aggregate System Entry Point in respect of Days in the calendar month.

2.13.3 In relation to each Aggregate System Entry Point and a calendar month, Transco shall pay to each relevant User an amount ("**Capacity Revenue Neutrality Charge**") determined as:

(a) where one or more Users hold Registered Monthly System Entry Capacity at the Aggregate System Entry Point in relation to the calendar month:

$$RCR * URC / ARC$$

where:

RCR is the Relevant Capacity Revenues;

URC is the User's Registered Monthly System Entry Capacity; and

ARC is the aggregate of all Users' Registered Monthly System Entry Capacity, for that Aggregate System Entry Point in relation to the calendar month;

(b) where no User holds Registered Monthly System Entry Capacity at the Aggregate System Entry Point in relation to the calendar month:

$$RCR * AURC / AARC$$

where:

AURC is the aggregate of the User's Registered Monthly System Entry Capacity;

AARC is the aggregate of all Users' Registered Monthly System Entry Capacity;

and 'RCR' has the meaning in paragraph (a) above, for all Aggregate System Entry Points in relation to the calendar month (provided that in the event that no Monthly System Entry Capacity was held by any User at any Aggregate System Entry Point for the calendar month, 'AURC' and 'AARC' shall be determined on the basis of the most recent calendar month in respect of which a User held Monthly System Entry Capacity at an Aggregate System Entry Point).

2.13.4 In relation to each Aggregate System Entry Point and a calendar month, each relevant User shall pay to Transco an amount ("**Capacity Cost Neutrality Charge**") determined as:

$$RCC * AURC / AARC$$

where:

RCC are the Relevant Capacity Costs;

and 'AURC' and 'AARC' have the meanings in paragraph 2.13.3(b), for all Aggregate System Entry Points in relation to that calendar month;

2.13.5 For the purposes of this paragraph 2.13:

(a) the "**Capacity Neutrality Adjustment Amount**" for a calendar month (month 'm') is

(i) the sum of:

(1) the amount of any charge of a kind referred to in the definition of Relevant Capacity Revenues, and of any Capacity Neutrality Charge (payable to Transco), which was due for payment to Transco in month m-2 but were unpaid to Transco as at the last Day of month m;

(2) the amount of any interest paid (in accordance with Section S4.3.2) by Transco to any User on any Day in month m by virtue of the User having made an over-payment in respect of any of such amount as is referred to in paragraph (1) above;

less

(ii) the sum of:

- (1) the amount of any charge of a kind referred to in the definition of Relevant Capacity Revenues, and of any Capacity Neutrality Charge (payable to Transco) which:
    - (A) was unpaid as at the last Day of month m-3 and was taken into account (under paragraph (a)(i) above) in calculating the Capacity Adjustment Neutrality Amount for month m-1, but
    - (B) has been paid to Transco since the last Day of month m-1;
  - (2) the amount of any interest paid (in accordance with Section S4.3.2) by any User to Transco on any Day in month m by virtue of late payment of any such charge as is referred to in paragraph (1) above;
- (b) "**Capacity Neutrality Charges**" comprise Capacity Revenue Neutrality Charges, Capacity Cost Neutrality Charges and Capacity Adjustment Neutrality Charges;
  - (c) "**Relevant Capacity Charges**" comprise Relevant Capacity Revenues and Relevant Capacity Costs; and
  - (d) a "**relevant User**" is a User registered as holding Monthly System Entry Capacity at an Aggregate System Entry Point for the calendar month;

2.13.6 In relation to a calendar month (and all Aggregate System Entry Points), where:

- (a) the Capacity Neutrality Adjustment Amount (if any) is negative, Transco shall pay to each relevant User; and
- (b) the Capacity Neutrality Adjustment Amount (if any) is positive, each relevant User shall pay to Transco,

an amount ("**Capacity Neutrality Adjustment Charge**") determined as:

$$\text{CNAA} * \text{AURC} / \text{AARC}$$

where CNAA is the Capacity Neutrality Adjustment Amount and 'AURC' and 'AARC' have the meanings in paragraph 2.13.3(b) (provided that in the event that no Monthly System Entry Capacity was held by any User at any Aggregate System Entry Point for the calendar month, 'AURC' and 'AARC' shall be determined on the basis of the most recent calendar month in respect of which a User held Monthly System Entry Capacity at an Aggregate System Entry Point).

2.13.7 Capacity Neutrality Charges shall be invoiced and payable in accordance with Section S.

Amend paragraph 3.5.1(ii) to read as follows:

"3.5.1(ii) **Commodity Charges ("NTS Commodity Charges")** in respect of its use of the NTS on any Day, or a charge payable by reference to incentive arrangements contained in the Transco Licence."

## TRANSITION DOCUMENT PART II

*Delete paragraph 8.1.11.*

***Representations are now sought in respect of this Draft Report and prior to Transco finalising the Report***



Signed for and on behalf of Transco.

Signature:

**Tim Davis**  
**Head of Regulation NT&T**

Date: