

Network Code Modification Proposal Ref 490a

Short title: Adjustment to ASEP Capacity Revenue Neutrality calculation – Transco Alternative

Date: 21st August 2001

Proposed Implementation Date: 29th August 2001

Urgency: Urgent

Justification:

BG Energy Services have proposed an Urgent Modification to the capacity incentive mechanism to “improve the cost targeting of any buyback costs for the forthcoming auctions.” This proposal, if approved would be implemented in time for the MSEC and MISEC entry capacity auctions commencing Wednesday 29th August 2001.

This alternative Modification Proposal has been raised to clarify the basis for “Effective Capacity Entitlement” at an ASEP level and proposes a similar driver for the apportionment of costs across all ASEP’s.

The raising of this alternative proposal should not be taken as indication of Transco’s support for the concept, nor for making any modification to the Auction arrangements at such short notice.

Nature of Proposal:

The existing capacity incentive mechanism apportions daily revenues and costs between Transco and Shippers on a 20:80 ratio, subject to Transco’s monthly cap of £416,000. This is subject to Transco’s Modification 488 which would see a suspension of its’ neutrality exposure, effectively placing all capacity surrender (buyback) costs onto MSEC holders at all ASEPs.

This proposal seeks to change the apportionment of these buyback costs to a more cost reflective basis, reducing the extent of existing cross-subsidies between constrained and unconstrained ASEPs. This Modification does not alter the apportionment of any incremental daily sales revenues and improves the symmetry between the two mechanisms.

Capacity Incentive Costs incurred on a Day should be apportioned between Shippers as follows:

50% in proportion to a shippers Effective Capacity Entitlement at the Constrained ASEP(s). (This includes MSEC, MISEC (where applicable), effective DAI and WDF entry capacity, adjusted for accepted buy back bids and shipper to shipper trades).

Plus

50% in proportion to a shippers Effective Entitlement (as defined above) at all ASEPs.

These costs would be targeted to Users holding the effective capacity on a Day, rather than the initial relevant User of the capacity.

Purpose of Proposal:

To improve the cost redistribution of capacity surrender charges between Users. This Modification proposal is independent of the outcome of Transco's Modification Proposal 488. If the existing mechanism is retained, then effectively the split would be 20% Transco; 40% Constrained ASEP (all effective capacity) and 40% all ASEP MSEC. Otherwise, the basis outlined above would become effective.

It is relevant to apportion costs to the holders of the capacity on a Day rather than the initial capacity holder. The current mechanism may inhibit the secondary market in capacity trading.

It is also relevant to apportion the costs over all effective capacity at the end of the Day at the constrained terminal rather than just the MSEC capacity. This is demonstrated by the fact that Transco often have to buy back capacity that has been released at the day ahead stage, either firm or interruptible.

The proposal apportions a higher proportion of capacity surrender costs to the ASEP where Users are able to surrender capacity. This seeks to improve the cost redistribution whilst still recognising the substitutability of entry capacity between certain ASEPs.

Furthering relevant objectives:

To improve the economic and efficient distribution of Capacity Surrender costs between Users by reducing the cross-subsidy between constrained and unconstrained capacity holders. The re-apportionment of costs should also improve secondary market trading of entry capacity.

Consequences of not making this change:

The entry capacity auctions continue as defined within the Network Code and as may be amended by Modification 488.

It is likely that Relevant Users holding ASEP MSEC entry capacity will pay a multiple of their bid price in Relevant Capacity Costs. This is discriminatory and may distort the bidding behaviour in the primary auction.

Area of Network Code concerned: Section B

Identity of Proposer's representative: Nigel Sisman

Proposer: Tim Davis

Company: Transco