Modification Report
URGENT Modification Reference Number 0366

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

1. Circumstances Making this Modification Proposal Urgent:

In accordance with Rule 9.1.2 Ofgem agreed that this Modification Proposal should be treated as urgent. This Modification proposes a change to the overrun regime implemented under Modification 0314 (Development of Entry Capacity Entitlement Based on an SND Profile). The Modification concerns the level of overrun charges that shippers may be liable to pay on unconstrained days.

2. Procedures Followed:

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

Modification agreed as urgent	20th October 1999
Close out for shipper representations	3rd November 1999
Final Modification report to Ofgem	10th November 1999
Ofgem decision expected	*18th November 1999*

3. The Modification Proposal:

The proposal is that on days when there is no capacity constraint at an ASEP, and where a User delivers gas to the system in excess of the User's Available System Entry Capacity at that ASEP, the overrun charge shall be 8 times the Applicable Daily Rate for Monthly System Entry Capacity at that ASEP for that day.

Where Transco need to buy back or curtail firm capacity below SND levels for a Gas day, the overrun charges shall continue be the greater of:

(a) 8 times the Applicable Daily Rate for Monthly System Entry Capacity at that ASEP for that gas day; and

(b) the lesser of:
i. 1.5 times SAP for that gas day; and
ii 17.7 p/therm.

Note: (b) ii is derived from the existing regime as implemented by Modification 0357 (Amendment to System Overrun Charge in Respect of Entry Capacity Entitlements based on a Seasonal Normal Demand Profile).

4. Transco's opinion:

Transco does not believe that this proposal should be implemented. It would introduce two quite different mechanisms for the calculation of overrun charges. OFGEM indicated in their New Gas Trading Arrangements decision document of September 1999 that they did not believe that there should be a requirement for a separately priced overrun regime dependent on whether or not a terminal is constrained.

Transco is of the opinion that the range of capacity services available to Users, including the provision of daily Interruptible capacity, should enable all Users to obtain sufficient capacity to maintain a minimal application of overrun charges. The creation of dual overrun charging methodologies may undermine incentives to book capacity. In consequence, the value of firm capacity holdings may be devalued if Users flow gas without capacity that causes restrictions to be placed upon legitimate capacity holders.

Transco is concerned that system constraints could develop within day that lead to a change in the appropriate methodology for calculating overruns at a stage in the day when Users will be left with little time to respond. Whereas the present methodology affords Users with a constant firm incentive that shippers can mitigate through trading or purchase of interruptible capacity. A methodology that provides for charges to change at short notice with potentially little opportunity for compensating action leaves users exposed to a degree of price uncertainty and is unlikely to provide for efficient outcomes.

The proposal provides for the overrun rates to be linked to gas prices only when Transco has to buy back or curtail firm capacity below SND levels. However, Transco believes that the proposal does not recognise that capacity could be curtailed on days when demand is greater than SND. On these days of high system usage, if transportation difficulties occur, then the applicable overrun charges may not provide enough incentive to flow gas within booked capacity levels.

Transco remain of the opinion that the present methodology presents a process that is best equipped for reflecting changing circumstances that may occur within day.

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

Transco do not believe that implementation of this proposal will further the objectives.

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

a) implications for the operation of the System:

It is possible that the overrun incentive is diminished to a degree that could encourage more gas to be delivered to entry points than had been signaled through the entry capacity booking regime.

b) development and capital cost and operating cost implications:

The development of a two part overrun regime, although initially contemplated in the business rules was not a feature of the regime during the systems development phase of NGTA. Consequently the functionality required by this proposal has not been built into the RGTA capacity system. If this proposal were to be approved then significant development time and expenditure would be required to build the systems functionality. Alternatively manual processes would be required with a consequent increased risk of invoicing errors.

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:

Further development of the systems would be required to implement this proposal. The costs associated with such development would be in addition to the significant amounts already invested by Transco for the NGTA process.

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

There are no known consequences.

7. 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:

Reductions to the level of overrun charges will increase the probability that Transco will need to take action to address constraints. This could lead to an increase in Transcos exposure under the incentive regime.

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

The system as developed does not have the functionality to operate a two part overrun regime. Further development of the systems would be required to implement this proposal. The costs associated with such development would be in addition to the significant amounts already invested by Transco for the NGTA process. Changes may also be required to shipper systems to accommodate and validate dual overrun charges.

9. The implications of implementing the Modification Proposal for Users:

Users will, if the proposal is implemented, be subject to an overrun regime, the calculation of which is dependent upon the existence of system constraints. It is anticipated that Users in the main, will face lower overrun charges on unconstrained days. In view of this, the incentive for a User not to deliver gas in the absence of sufficient capacity entitlement may be diminished which could lead to an increase in the instances of constraints and effectively undermine firm capacity previously purchased by shippers.

10. The implications of implementing the Modification Proposal for Terminal Operators, Consumers, Connected System Operators, Storage Operators suppliers, producers and, any Non-Network Code Party:

If implemented, it is suggested that the proposal may increase the flexibility of short term gas supplies for Users.

11. 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:

N/A

12. Analysis of any advantages or disadvantages of the implementation of the Modification Proposal:

Advantages:
Users overrun charges will be reduced on days when no constraints appear on the pipeline system.

Disadvantages:
Users cannot be clear which overrun methodology will apply before the gas day.
A dual overrun functionality is not available within RGTA capacity system, consequently further systems development will be required.

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

There were 17 representations submitted in response to this proposal. Respondents were; Alliance Gas (AG), BG Storage (BGS), British Gas Trading (BGT), BP Gas (BP), Conoco (C), Dynegy (Dyn), Elf Gas and Power Ltd (EGP), Esso (ES), Mobil Gas Marketing, (MGM), National Power (NP), Quantum (Q), Scottish Power (SP), Scottish and Southern Energy (SSE), Shell Gas Direct (SGD), Total Gas Marketing Ltd (TGM), Yorkshire Energy (YE), and the proposer Eastern Power and Energy Trading Ltd (EPETL).

The proposal is supported by 16 respondents
The proposal is not supported by 1 respondent
The respondent who does not support the proposal does however, express support for the principles of the proposal.

The issues raised in representations are considered below under the following headings;

Clarification of applicable daily rate
Duration of Modification
Interaction with Monthly Capacity Auction
Level of overrun
Manipulation of Prices

Clarification of applicable daily rate
Two respondents (BGS, SSE) requested clarification of the applicable daily rate that will be used to calculate overrun charges. The Modification Proposal had indicated that on days when there is no constraint at an ASEP the overrun charge will be 8 times the Applicable Daily Rate for Monthly System Entry Capacity at the ASEP for that day.

The overrun rate at locations where Monthly System Entry Capacity has been offered is the greater of 1.1 times the highest bid price accepted on D-1 in the daily entry capacity auction, 1.1 times the highest offer price accepted at D-1 in the buy back market, 8 times the applicable daily rate for monthly system capacity and 1.5 times SAP. The applicable daily rate is defined in the transportation statement as the average of the top 50% by volume, of accepted bids ranked in price order in the series of primary auctions at each entry point.

Duration of Modification
Two respondents (AG, BGT) have indicated that their support for this modification is on the basis of it being a temporary measure that should be superseded by a within day capacity market. A within day capacity market is considered by them to be preferable to a two part overrun methodology.

Interaction with Monthly Capacity Auction
One respondent (MGM) did not support the proposal at this time because if approved, it is perceived that it would change the value of Monthly System Entry Capacity which was sold through auction in September 1999. Based on this objection it would offer support for a phased introduction of the proposal. With introduction as soon as possible at ASEPs where daily capacity only is available followed by implementation with effect from 1 April 2000 at those ASEPs where monthly capacity is allocated.

Level of overrun
A number of respondents (AG, BGS, C, NP, SGD) supported the proposal on the basis that it will provide a charge that is thought to be more proportionate to the consequence of overrunning on days with no system difficulties.

Manipulation of Prices
One respondent (SSE) highlighted a concern that a link between overrun charges and D-1 capacity prices cannot adequately reflect the market value of capacity on the gas day and such prices could be open to manipulation, given their use in deriving overrun charges.

Transco Response:

Transco agrees that it is desirable to have a methodology that generates overrun charges that maintain incentives to book capacity whilst avoiding implementation of charging levels that are out of proportion to the business needs. It is also desirable that the probable level of charges are known to users before the gas day. This proposal, if implemented fails to make known to Users the applicable level of charges before the gas day. Users must therefore make a judgment before the gas day which may lead to a greater level of uncertainty regarding the overrun rate to be anticipated.

Transco agrees that if the proposal is implemented it would be desirable to limit its effective life to the period before implementation of within day capacity trading. However an end date near the 1st quarter of 2000 and a lead time for development of UK-Link processes imply that the effective life of the proposal may be unreasonably short and justification of development costs will consequently become questionable.

Transco believes that it may be unhelpful to change services once sold because such changes may often result in a change in perception of value that would otherwise have generated different outcomes when the services were purchased. Changing overrun charges may have such an effect upon Monthly System Entry Capacity prices.

Transco agrees that in illiquid markets it may be possible to set rates for overrun charges through bids for daily system capacity. However, this may only be said to apply at ASEPs where daily capacity charges determine the overrun rate.

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

Not applicable

15. The extent to which the implementation is required having regard to any proposed change in the methodology established under Standard Condition 3(5) of the statement; furnished by Transco under Standard Condition 3(1) of the Licence:

Not applicable

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

Transco recommends that this proposal is not implemented and no programme of works is required

17. Proposed implementation timetable (inc. timetable for any necessary information systems changes):

Transco recommends that this proposal is not implemented and no timetable is required

18. Recommendation concerning implementation of the Modification Proposal:

Transco recommends that this proposal is not implemented and seeks agreement from the Director General in accordance with this recommendation.

19. **<u>Transco's Proposal</u>:**

This Modification Report contains Transco's proposal not to modify the Network Code and Transco now seeks agreement from the Director General in accordance with this report.

Signed for and on behalf of Transco.

Signature:

Tim Davis
Manager, Network Code

Date:

Director General of Gas Supply Response:

In accordance with Condition 7 (10) (b) of the Standard Conditions of Public Gas Transporters' Licences dated 21st February 1996 I hereby direct Transco that the above proposal (as contained in Modification Report Reference **0366**, version **1.0** dated 10/11/1999) be made as a modification to the Network Code.

Signed for and on behalf of the Director General of Gas Supply.

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

Restrictive Trade Practices Act - Suspense Clause

For the purposes of the Restrictive Trade Practices Act 1976, this document forms part of the Agreement relating to the Network Code which has been exempted from the Act pursuant to the provisions of the Restrictive Trade Practices (Gas Conveyance and Storage) Order 1996. Additional information inserted into the document since the previous version constitutes a variation of the Agreement and as such, this document must contain the following suspense clause.

1. Suspense Clause

1.1 Any provision contained in this Agreement or in any arrangement of which this Agreement forms part by virtue of which this Agreement or such arrangement is subject to registration under the Restrictive Trade Practices Act 1976 shall not come into effect:

(i) if a copy of the Agreement is not provided to the Director General of Gas Supply (the "Director") 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 Director 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 paragraph 2(3) of the Schedule to The Restrictive Trade Practices (Gas Conveyance and Storage) Order 1996.

provided that if the Director does not so approve the Agreement then Clause 1.2 shall apply.

1.2 Any provision contained in this Agreement or in any arrangement of which this Agreement forms part by virtue of which this Agreement or such arrangement is subject to registration under the Restrictive Trade Practices Act 1976 shall not come into effect until the day following the date on which particulars of this Agreement and of any such arrangement have been furnished to the Office of Fair Trading under Section 24 of the Act (or on such later date as may be provided for in relation to any such provision) and the parties hereto agree to furnish such particulars within three months of the date of this Agreement.