

Draft Modification Report
Modification Reference Number 0365

Availability of Within Day Capacity

This draft Modification Report is made pursuant to Rule 8.9 of the Modification Rules and follows the format required under Rule 8.9.3.

1. The Modification Proposal:

The following proposal has been developed from a shipper raised Modification Proposal which seeks to oblige Transco to make within-day capacity available to shippers and to develop within-day 'buy backs' to replace capacity scaling. A Development Workgroup was set up to progress the Modification Proposal and the detailed discussions held by the group are provided in the Workgroup Report dated 26 January 2000. The proposal below is being put forward by Transco, and in many areas, takes account of the Workgroup discussions. However, it should be noted that agreement was not reached in all areas and this proposal articulates Transco's preferred option:

The holding of Daily Firm System Entry Capacity (DSEC) gives a shipper a firm entitlement to deliver gas into the System from a specified ASEP (Aggregate System Entry Point) for a single day only. Where a shipper is registered as holding DSEC in advance of the gas day, the holder will be entitled to deliver gas at a rate not exceeding $1/24$ th of the daily entitlement per hour. Where a shipper is registered as holding DSEC within the gas day, the holder will be entitled to deliver gas at a rate not exceeding $1/n$ th of the registered end of day quantity where n is the number of hours remaining in the gas day from the time of registration.

Shippers will be able to place bids for Daily System Entry Capacity (DSEC) in respect of any gas day. Shippers will place bids for DSEC from 06.00 hrs. on D-7 up to 03.59 hrs. on D-1 and from 06.00 hrs. until 02.00 hrs. on D. Bids will specify the ASEP, the quantity, the minimum quantity, and the bid price. Transco will reject any bid where the bid price is less than the applicable reserve price or the quantity (or minimum quantity) is less than 100,000 kWh/day.

There will be no distinction between before the day and within day requirements for bidding purposes, and the effective registration time of a successful bid will be the later of 06.00 hrs. at the start of the gas day, the next hour plus one ("hour bar") after the time of posting, or the next hour plus one after the acceptance of the bid by Transco. It is also proposed that shippers within day bids should be expressed as end of day quantities and that shippers should have the option to place bids where the end of day quantity will remain fixed during the day or will reduce at each hour bar.

Shippers will be able to view, on an anonymous basis, the prevailing bid list in respect of buys and surrenders at each ASEP. It is proposed that this facility will be available for bids submitted both before the day and within day.

Shippers will be able to have up to 20 live buy bids and 20 live surrender bids in respect of each ASEP and will have the facility to withdraw or revise their bids.

It is proposed that Transco will continue to assess bids on D-1 at approximately 13.00 hrs and accept bids for both the purchase of DSEC and the surrender of firm System Entry Capacity as necessary. Shippers will be notified of the outcome of this process by 15.00 hrs as is currently the case. Transco will also assess bids with a view to releasing additional DSEC or buying back at times where the availability of firm System Entry Capacity is likely to change following demand attribution times and changes in delivery capability.

Transco will also consider the acceptance of bids on a regular basis where there has been no change in the availability of capacity by ASEP but when bids placed by shippers for both buying of DSEC and the surrender of firm System Entry Capacity have changed to the extent that Transco will benefit under the capacity incentive mechanism from the acceptance of bids and combinations of bids.

Transco will ordinarily notify shippers of accepted bids within one hour of the bid acceptance period. When Transco accepts bids for the purchase or surrender of System Entry Capacity there will be an acceptance period of 15 minutes when the bidding screens will “freeze” and shippers will be unable to place, withdraw or modify bids.

Where additional DSEC is available at an ASEP, Transco will accept bids in price order (highest priced first) and existing Network Code rules will apply for tied bids and part bid acceptance. In circumstances where DSEC could be made available at more than one location Transco will rank all bids at relevant ASEPs and bid acceptance will again be in price order. For capacity surrenders at an ASEP, the same principles will apply except that lowest priced bids will be accepted first.

Transco proposes that shippers will pay for their daily capacity based on the accepted bid price, rather than the lowest priced accepted bid as is currently the case in the D-1 auctions. Transco believes that this will remove an unintended feature of the existing incentive regime whereby Transco can reduce its income by releasing additional capacity which depresses the clearing price. Transco’s view is that “pay your bid” pricing will help to address this point, and is more suitable for the proposed market where capacity can be sold at several times during the day as opposed to in a single transaction on D-1 as is presently the case.

Transco has acknowledged that it is appropriate to review the level of reserve prices set for daily firm capacity and has proposed a reduction. The details of this are contained in pricing consultation paper PC51, and the specific price implemented will be the subject of the pricing consultation exercise.

A significant area of discussion within the Development Workgroup has been the future role of interruptible daily capacity, with most shippers requesting that the present level of interruptible availability continues. However, Transco believes that with the introduction of within day daily firm capacity, the proposed increase in monthly capacity, and a reduction in the floor prices for daily capacity, the need for

interruptible capacity at the levels seen to date will fall away. Transco proposes that the availability of interruptible capacity will be limited to use-it-or-trade-it on D-1, as is currently the case, and an incremental amount which is calculated as the amount by which, in Transco's view, capacity availability could increase within day based on forecast conditions.

This proposal also includes an amendment to the overrun regime. The elements of the overrun which are related to the offer prices of accepted bids and surrenders of capacity for the day in question will be limited to bids and surrenders accepted up to midnight on D-1. This is to ensure that shippers will know what the possible parameters of an overrun could be, prior to delivering gas.

A feature of this proposal is the facility for Transco to "buy back" firm capacity within day as opposed to applying a uniform scale back of rights. However, in extreme circumstance it may not be possible for Transco to buy back due to, for example, systems failure or a complete absence of bids. In such circumstances Transco will advise a flow reduction at the ASEP in question and the existing liability provisions for "Failure to accept gas tendered for delivery" within Section I of the Network Code will apply.

During the Development Workgroup discussions, a number of shippers requested that Transco provide an indication on D-1 of the amount of DSEC that is available at each ASEP in respect of the coming gas day. As part of this proposal Transco will publish an indicative availability of DSEC at each ASEP by 12.30 hrs on D-1.

2. Transco's Opinion

Transco is of the opinion that the development of a within day market for the buying and selling of System Entry Capacity is a logical next step in the RGTA process. As is presently the case with energy trading, it may be appropriate for a third party to facilitate a screen based cleared market for capacity trading. However, until an effective independently run market has been established, Transco believes that the proposed within day mechanism would provide an appropriate means for the increase, decrease and redistribution of capacity rights.

The issue of interruptible capacity availability has prompted discussion both within and outside of the Development Workgroup. Transco believes that the need to sell interruptible daily capacity to the extent that it is currently sold is a direct result of there being no within day market. Consequently the development of a within day market will remove the need for interruptible capacity other than that derived on a "use it or lose it" basis or that which could be attributed to the uncertainty level of Transco's firm capacity availability calculations on D-1. Transco is not clear that a within day capacity market can operate effectively, allowing the market to value capacity rights, unless the available quantity of interruptible capacity is curtailed.

Transco believes that charging for daily capacity on a "pay your bid" basis is a worthwhile step which would achieve the following objectives:

- ♦ Transco's incentives will be more closely aligned with shippers' desire that Transco maximises the level of capacity it make available.
- ♦ There would be a reduced incentive to manipulate overrun charges, which have an effect on secondary market prices, by bidding to buy quantities of capacity at high prices, since successful bids would have to pay the high bid price as opposed to any lower clearing price.
- ♦ Daily pricing would be consistent with the pricing for Monthly System Entry Capacity.

In terms of the timing of implementation, Transco is of the opinion that 1 April may not allow sufficient time for system testing. A revised implementation date of 1 June 2000 is now recommended in order to ensure that the required systems can be robustly developed and tested. It is important that shippers are fully aware of the start time of a within day market at the time of the next round of monthly capacity auctions as its existence, or otherwise, may influence bidding strategies.

Transco recognises shipper concerns regarding the pricing of daily firm capacity services and has proposed a reserve price reduction, which is set out in pricing consultation paper PC51 and is subject to a separate consultation exercise.

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

Transco believes that this proposal may better facilitate the relevant objectives in two ways.

Firstly in respect of the efficient and economic operation of the pipeline system. The proposed mechanism ensures that the available transportation capacity can be allocated between shippers on the basis of their own valuations. Under the existing arrangements capacity is allocated and surrendered on the basis of price ahead of the day, but within day changes, if needed, are conducted on a uniform basis which does not take account of shipper valuations. The proposal would provide the potential for allocative efficiency to be achieved within day as well as ahead of the day.

The second area in which the proposal may better facilitate the relevant objectives is in the promotion of competition between shippers. This proposal will allow shippers greater control over their capacity rights by increasing the within day "firmness" of the service. This may provide a better platform for shippers to develop delivery flexibility in order to take advantage of the proposed market and potentially achieve lower costs by responding to price signals.

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

a) implications for the operation of the System:

The introduction of a within day capacity market will represent a change in the way Transco optimises and makes available entry capacity. Other than to address market failure, it will remove the need for capacity scaling and allow Transco to 'buy back' capacity or make additional capacity available on a real time basis within the gas day.

Transco will be required to assess the level of entry capacity availability at each ASEP and the level of demand for that capacity on a frequent basis within day, and to make decisions on whether to buy or sell capacity through the proposed mechanism.

b) development and capital cost and operating cost implications:

Transco will incur significant IT development costs associated with the provision of a within day capacity market, a capacity registration service and a shipper bulletin board. Transco will absorb these costs within the present price formula.

The increase in the administration effort to support daily capacity auctions and the allocation of capacity will represent an increase in operating 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 development and ongoing costs will be accounted for under the price control formula and Transco does not intend to seek additional costs for the provision of the within day market in the present formula period.

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

The recommended changes are not anticipated to have immediate price regulation consequences. However, the introduction of within day capacity auctions and the effect this may have on shippers' strategy towards monthly capacity auctions may have an impact on the level of revenue Transco recovers through Monthly System Entry Capacity which will feed through to 'k' in the present price control formula.

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 introduction of a liquid within day market would mean that Transco would not use a uniform scale back to address System Entry Capacity constraints within day. In such circumstances it would have to buy back and may, as a result, be subject to a greater financial exposure. The reduction in the availability of interruptible capacity would provide a potential increase in the income Transco receives for the sale of DSEC but carries an increased risk of incurring cost as a greater proportion of unavailable capacity will have to be bought back as opposed to interrupted.

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

Transco's computer systems require significant development to facilitate the introduction of a within day capacity mechanism and are presently being modified on the basis that the principles of the existing D-1 auction will be incorporated into the new process.

The support systems that are used to assess the optimal level of capacity availability at each ASEP and the allocation of capacity to shippers would also require development to handle the increase in complexity and provide an improvement in response times as deemed necessary.

Transco's provision of a capacity bulletin board service has also required the building of a new system which has to be compatible with the RGTA capacity system.

The specification of the new systems has been designed such that they can interface with third party computer systems to cater for the possible event that a capacity market could be provided by a third party market operator, similar to the arrangements for the OCM.

Users would require an understanding in the use of new computer screens for the placing of bids and their capacity allocation, in addition to changes in invoice types.

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

Users would have the opportunity to purchase and make available daily capacity beyond the present gate closure of 13:00 hours at D-1.

Consistent with the provision of a within day capacity market, which would further provide shippers with an opportunity to match their capacity holdings to their requirements for a day, the levels of interruptible capacity which have previously been made available at D-1 would be likely to be significantly reduced and the role of interruptible capacity diminished.

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

Improvements in the use of daily capacity services may reduce the likelihood of terminal constraints and thus the likelihood of large flow rate reductions at entry points.

Procedures for managing constraints would be changed to reflect the implementation of this proposal.

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 setting of a revised reserve price for Daily System Entry Capacity would be subject to a pricing consultation exercise.

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

Advantages

- i. Allows shippers to adjust their capacity holding level for any gas day beyond the present cut-off of 13:00 hours D-1
- ii. Creates better alignment between Transco's incentives and shippers' desire to see available capacity maximised.
- iii. In most circumstances, replaces the process of "scaling back" capacity with a regime that recognises the value that individual shippers place on capacity
- iv. Potentially increases liquidity in secondary trading of capacity, due to reduction of interruptible capacity

Disadvantages

- i. May reduce perceived importance of advance booking of monthly capacity
- ii. Cost and complexity of the proposed changes may outweigh the anticipated benefits
- iii. If the reduction in interruptible capacity availability results in shippers facing higher capacity costs, this could result in higher priced bidding on the OCM.

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

Representations on the draft modification report are now sought as part of the consultation process.

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 safety or other legislation.

13. 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 License:

Implementation is not required as a consequence of 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 License:

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

Finalise system design requirements,
Evaluate systems changes within Transco and Shipper systems,
Design and build systems,
Test systems with Transco and Shippers,
Test linkages between systems,
Implement training programs within Transco and Shippers,
Amend systems to reflect observations during training and testing,
Re-test systems,
Implement changes.

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

Subject to satisfactory completion and testing of systems, the recommended implementation timetable, if the Modification Proposal is implemented, is as follows :

1. Shippers capacity bid window opens for Daily System Entry Capacity
 - 25 May 2000 (at D-7 for 1 June 2000)
2. Commencement of Within Day Capacity Auctions
 - 31 May 2000 (at D-1 for 1 June 2000)

16. Recommendation concerning the implementation of the Modification Proposal:

17. Text :

Attached

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
Manager, Network Code

Date: